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CIS

TAX-EXEMPT INDUSTRIAL DEVELOPMENT BONDS

HEARING

BEFORE THE

SUBCOMMITTEE ON
URBAN AND RURAL ECONOMIC DEVELOPMENT

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

TAX-EXEMPT INDUSTRIAL DEVELOPMENT BONDS

OCTOBER 5, 1981

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CONTENTS

Statement of Senators—

Page
D'Amato, Hon. Alfonse M., a U.S. Senator from the State of New York, and chairman, Subcommittee on Urban and Rural Economic Development of the Committee on Small Business 1
Dixon, Hon. Alan J., a U.S. Senator from the State of Illinois 23
Levin, Hon. Carl, a U.S. Senator from the State of Michigan 5
Sasser, Hon. James R., a U.S. Senator from the State of Tennessee 4
Stafford, Hon. Robert T., a U.S. Senator from the State of Vermont 210
Stevens, Hon. Theodore F., a U.S. Senator from the State of Alaska 6
Weicker, Hon. Lowell, Jr., a U.S. Senator from the State of Connecticut, and chairman, Committee on Small Business 17

Statement of Representative—

Bedell, Hon. Berkley, a U.S. Representative from the State of Iowa, and chairman, Subcommittee on Energy, Environment, and Safety Issues Affecting Small Business of the House Committee on Small Business 25

Statement of—

Auffarth, Hank, account officer, Chemical Bank of New York 180
Bean, Ronald, president, Council of Pollution Control Financing Agencies, and executive director, Illinois Environmental Facilities Financing Authority, State of Illinois 57
Carson, John J., deputy commissioner, Department of Economic Development, State of Connecticut 54
Cohalan, Peter F., county executive, Suffolk County, State of New York 143
Donovan, Hon. Tim, State Representative, Illinois State Legislature, Decatur, Ill 182
Ferolito, Deborah P., deputy executive director, New York City Industrial Development Agency 179
Patterson, Robert E., executive director, Massachusetts Industrial Finance Agency, State of Massachusetts 61
Rutkowski, Edward J., county executive, County of Erie, State of New York 146
Schuman, Kenneth S., commissioner, New York City Office of Economic Development 177
Smith, Robert J., president, Smith Brothers Insurance, Inc., South Windsor, Conn 175
Snelling, Hon. Richard A., Governor of Vermont, and chairman, National Governors Association 210
Vaughan, Roger, deputy director, Office of Development Planning, State of New York 39
Williams, Thomas K., commissioner of revenue, State of Alaska, and vice chairman, Alaska Industrial Development Authority 59

APPENDIX

Statement of the International Council of Shopping Centers, New York, N.Y 244
Letter dated October 2, 1981, to Senator Alfonse M. D'Amato, from C. Tiffany Bingham, Jr., executive vice president, Memphis Area Chamber of Commerce, Memphis, Tenn 263
Letter dated October 5, 1981, to Members of the Committee, from John G. Fitzpatrick, associate director, Maryland Industrial Development, Baltimore, Md 275
Letter dated October 9, 1981, to James O'Connell, economist, U.S. Senate Small Business Committee, from James J. Hughes, Jr., executive director, New Jersey Economic Development Authority 289

Page
Statement of Richard L. Hanneman, director, Government and Public Affairs, National Solid Wastes Management Association 294

HEARING DATE

October 5, 1981:

Morning session 1

TAX-EXEMPT INDUSTRIAL DEVELOPMENT BONDS

MONDAY, OCTOBER 5, 1981

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON URBAN
AND RURAL ECONOMIC DEVELOPMENT,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 424, Russell Senate Office Building, Hon. Alfonse M. D'Amato, chairman of the subcommittee, presiding.

Present: Senators D'Amato, Weicker, and Dixon.

Also present: Robert J. Dotchin, staff director; James J. O'Connell, economist; Robert M. Wilson, counsel; Alan L. Chvotkin, chief minority counsel; and Bruce Ray, staff assistant to Senator D'Amato.

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK, AND CHAIRMAN, SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT OF THE COMMITTEE ON SMALL BUSINESS

Senator D'AMATO. The subcommittee hearing on tax-exempt industrial development bonds will come to order.

We have a list of very prominent witnesses.

Before we begin taking testimony, I would like to put my opening remarks on the record.

With interest rates as high as they are today and the availability of capital as limited as it is today, only the very largest companies can qualify or afford to borrow money using conventional types of financing. This is totally unacceptable.

Our Nation was built by small business. Its future lies in small business. We must find some way to make the necessary capital available so that today's small businesses are still around tomorrow. We cannot, as a nation, afford to have a disproportionately large number of our small businesses fail, nor can we afford an economic future in which small entrepreneurs are either unable to open new businesses or are unable to stay in business once they have taken that plunge.

Capital must be made available at reasonable interest rates. Perhaps the only way to do this is to allow tax-exempt interest to those providing capital. The amount of tax revenue lost through such a system is insignificant when compared with the overwhelming benefits that this system provides. Businesses are expanded; jobs are created; new construction increases; more people working means fewer individuals on the welfare rolls. In the end, more taxes are collected as both corporate profits and individual incomes increase.

The system just described is precisely the process created by the issuance of tax-exempt, small-issue industrial development bonds. Thus, it is completely inconceivable that there are those who oppose the issuance of these bonds.

As a former town supervisor of Hempstead, N.Y., I have seen firsthand the value of IDB's, and I would like to go on record as opposing their elimination.

IDB's are under attack. A recently introduced House bill would eliminate new issues after 1984 and scale down the program immediately.

Revenue ruling 81-216, issued by the IRS on August 24, 1981, prohibits the so-called umbrella bond programs.

It is rumored that the Treasury Department is preparing to propose the elimination of the entire IDB program. This cannot be allowed.

The Treasury Department was made aware of today's hearing. I personally extended an invitation for them to send a representative to detail their objections to the IDB program.

They chose not to attend. They chose not to make their objections public, perhaps because their reasons are indefensible.

Even if Treasury is correct and you can raise a little more revenue by eliminating the IDB program, what public purpose is served by denying small business the ability to expand? What public purpose is served by eliminating jobs and by making it more difficult to create new ones? What public purpose is served by eliminating the ability of local officials to use IDB's as a tool in the economic development of their community?

The answer, of course, is no purpose.

Let me quote from a study conducted last year by Norman Ture, now Under Secretary for Tax Policy and Economic Affairs. He wrote as follows:

> IDB's are productive instruments for promoting economic development by making savings and investment more attractive to individuals and businesses. Their use results in overall gains in capital formation, employment, and output, rather than merely changes in the location of economic activity.

Why is the Treasury seeking to end this vital and successful program?

According to the Congressional Budget Office, 84 percent of the over $8 billion of IDB's issued in 1980 were for the use of small- and medium-sized businesses. Forty-eight States have established industrial development authorities to issue revenue bonds.

Today we will receive testimony from economic development officials of five of these States. This subcommittee will also receive testimony from Senator Stevens and Representative Bedell, both active supporters of the IDB program. Governor Snelling, chairman of the National Governors Association, will testify, as will others intimately involved with IDB's.

In addition, I have prepared a short list of examples of the kinds of achievements and the successes in my State of New York which have resulted from the use of IDB's. I would ask that the balance of my remarks be included in total for the purposes of moving forward with this hearing.

[The prepared statements of Senators D'Amato, Sasser, and Levin follow:]

OPENING REMARKS BY SENATOR ALFONSE D'AMATO BEFORE THE URBAN AND RURAL ECONOMIC DEVELOPMENT SUBCOMMITTEE

With interest rates as high as they are today, and the availability of capital as limited as it is today, only the very largest companies can qualify or afford to borrow money using conventional types of financing. This is totally unacceptable.

Our Nation was built by small business. Its future lies in small business. We must find some way to make the necessary capital available so that today's small businesses are still around tomorrow. We cannot as a nation afford to have a disproportionately large number of our small businesses fail. Nor can we afford an economic future in which small entrepreneurs are either unable to open new businesses, or are unable to stay in business once they have taken the plunge.

Capital must be made available at reasonable interest rates. Perhaps the only way to do this is to allow tax-exempt interest to those providing capital. The small amounts of tax revenue lost through such a system is insignificant when compared with the overwhelming benefits that result. Businesses are expanded. Jobs are created. New construction increases. More people working means fewer individuals on the welfare rolls. In the end, more taxes are collected as both corporate profits and individual incomes increase.

The system just described is precisely the process created by the issuance of tax exempt, small issue industrial development bonds. Thus, it is completely inconceivable that there are those who oppose the issuance of these bonds. As a former town supervisor of Hempstead, N.Y., I have seen first hand the value of IDB's and I would like to go on record as opposing their elimination.

But IDB's are under attack. A recently introduced House bill would eliminate new issues after 1984 and scale down the program immediately. Revenue ruling 81-216, issued by the IRS on August 24, 1981, prohibits so-called umbrella bond programs. Now it is rumored that the Treasury Department is preparing to propose the elimination of the entire IDB program. This cannot be allowed.

The Treasury Department was made aware of today's hearing. I personally extended an invitation for them to send a representative to detail their objections to the IDB program. They chose not to attend. They chose not to make their objections public, perhaps because their reasons are indefensible. Even if Treasury is correct and you can raise a little more revenue by eliminating the IDB program, what public purpose is served by denying small businesses the ability to expand? What public purpose is served by eliminating jobs, and by making it more difficult to create new ones? What public purpose is served by eliminating the ability of local officials to use IDB's as a tool in the economic development of their community?

The answer of course, is "no purpose." Let me quote from a study conducted last year by Norman Ture, now Undersecretary for Tax Policy and Economic Affairs. He wrote that "IDB's are productive instruments for promoting economic development by making savings and investment more attractive to individuals and businesses. Their use results in overall gains in capital formation, employment and output, rather than merely changes in the location of economic activity." So why is Treasury seeking to end this vital and successful program?

According to the Congressional Budget Office 84 percent of the over $8 billion of IDB's issued in 1980 were for the use of small and medium sized businesses. Forty-eight States have established industrial development authorities to issue revenue bonds. Today we will receive testimony from economic development officials of five of these States.

This subcommittee will also receive testimony from Senator Stevens and Representative Bedell, both active supporters of the IDB program. Governor Snelling, chairman of the National Governors Association, will testify, as will several others intimately involved with IDB's.

In addition, I intend to leave the record of this hearing open for a short time following this hearing for anyone who wishes to submit written testimony. Such testimony on behalf of the International Council of Shopping Centers has already been received and will be included.

Finally, I would like to mention a few—in fact a very few because the complete list would be incredibly long—of the IDB's issued in my State which more than adequately demonstrate how vital this program is. Each of the bond issues to be cited resulted in the generation of new jobs or the retention of existing jobs that would otherwise have been lost. Each of the issues represents a responsible effort on the part of businessmen and local officials to contribute to the economic development of the community. Each of the issues served a vital public purpose. My only regret is that our time is so limited that I can present only an extremely abbreviated list of the IDB projects that have served New York State.

A $2.3 million IDB issued in 1979 allowed the Brockport Storage Co. of Brockport, N.Y., to construct a 63,146 square foot addition to permit the establishment of a frozen food distribution operation. Eight new jobs were created.

Crowley Foods of LaFrageville, N.Y., used a $1 million IDB to purchase equipment necessary for the production of cottage cheese and yogurt; 50 new jobs were created.

Phillips Cables of Watertown, N.Y., used a $2.8 million IDB to construct a whole new plant; 75 new jobs resulted.

Also in Watertown, N.Y., Air Brake, the largest private employer in the area, was able to create 400 new jobs through financing obtained with IDB's. And Fisher Gage used a $250,000 IDB to purchase zinc casting equipment; 18 new jobs were created.

Eighty jobs were created when Naarden International of Long Island City used a $1 million IDB to expand and renovate its plant.

Secutto Ice Cream Co. of Staten Island has used two IDB's totaling $1.7 million to expand; 56 new jobs resulted.

Chesebrough Ponds, the only industry in Oriskany Falls, New York, was able to add 30 new jobs through the addition of a cotton bleaching and drying facility financed with a $2 million IDB.

A $1 million IDB allowed Hamilton Digital Controls of Utica, New York, to add 30 new jobs.

Also in Utica a $1.2 million IDB allowed the Mele Manufacturing Company to add 200 new jobs, doubling its preexisting workforce.

Cochrane Hospital Supplies, of New Rochelle, New York, was able to create 35 new jobs with financing obtained through a $900,000 IDB issued in 1979. A $1.3 million IDB issued in 1980 allowed Wideband Jewelry to add 100 new jobs in the same area.

Hagedorn Communications has used a $100,000 IDB to construct a warehouse. M.F. Realty is using a $1 million IDB to construct a new 36,000 square foot manufacturing plant; 100 new jobs will be created when this project is finished.

Precision Filters of Ithaca, New York, will be able to expand from 35 to 70 employees with the assistance of a $400,000 IDB to construct a 27,000 square foot building to replace its old 2,400 square foot facility.

And the list of successful projects financed by IDB's goes on and on. I could continue citing these success stories for hours, but I think it is now time we hear from others.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE

Today's hearing examines the use of industrial development bonds by small business. At a time when the small business community is bearing the brunt of the present high interest rate policies of the Federal Reserve Board, this hearing is especially timely, I commend Chairman Weicker and subcommittee Chairman D'Amato for calling it.

The Internal Revenue Service recently issued revenue ruling 81-216 which eliminates this prime source of capital financing for small business. The ruling denies tax-exempt status for multiple lots of bonds of $1 million or less that are pooled and offered as one bond. These so-called umbrella bonds have assisted countless small businessmen and farmers in these times of record high interest rates.

The small business community is constantly plagued by a shortage of capital. Yet, small businesses desperately need capital for investment in plant or equipment or to maintain adequate inventory levels, and since small businesses are virtually prohibited from selling issues of stock to raise capital, small-issues industrial development bonds are highly beneficial to them.

Without reliance on small-issue industrial development bonds, small businesses are forced to borrow funds, often at two to three points above the prime rate in order to meet their capital financing needs. And all too often, we find that small businesses are going under, at record rates I might add, rather than continue to operate under the staggering burden of high interest rates.

Small-issue industrial development bonds have enabled small businesses to obtain working capital at 60 to 80 percent of the prime rate instead of paying their usual two points over prime. Thus, these bonds put into effect a "dual prime rate" policy that can keep small businesses afloat during this period of high interest rates.

The IRS ruling reverses three previous revenue rulings and changes a practice that has been established over a nine year period. It also has the effect of preempting congressional action on this matter for the time being.

This hearing will help us analyze the usefulness of small-issue industrial development bonds. It will help us identify any abuses which can be ultimately corrected by congressional or executive action, however, I am also sure that the hearing will point up the need to have a strong national policy of industrial development bonding that will help small businesses grow and expand in the years ahead.

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Today's hearing on the subject of small issue Industrial Revenue Bonds (IRB) and economic development comes at a most opportune time, and I want to complement Senators D'Amato and Dixon, chairman and ranking member of the Subcommittee on Urban and Rural Economic Development, respectively, for their interest and attention to this important matter. In light of the President's recently announced budget cuts and revenue raising proposals that he claims are necessary to meet the goal of a balanced budget by fiscal year 1984, we in Congress must ask ourselves whether the private sector alone has the capability, or interest, in aiding the economic development of urban and rural America. In particular, we must ask ourselves whether the private sector will meet the capital needs of those small and medium size businesses which in many instances are the key ingredients of successful economic development. Without some incentive, I think the answer is clearly that the private sector cannot or will not undertake this financing. The federal government has a legitimate role to, in quoting the Small Business Act, "aid, counsel, assist, and protect" small business.

Unlike larger corporations, small businesses find themselves at a distinct disadvantage in today's economy when seeking credit at reasonable rates. With interest rates high, and the cost of doing business increasing, small businesses are not favored customers with lending institutions. While large businesses are more able to bargain for rates below the "prime," small businesses are often charged a premium over the best rate that financial institutions will charge their large corporate customers. Furthermore, large businesses often have a variety of alternative financing sources available to them to meet their credit needs. Most small businesses do not have those options.

However, one option has generally been available to small businesses for selected financings—the industrial revenue bond. These tax-exempt bonds give small businesses the ability to compete with corporate giants for affordable capital.

In May of these year, Senator Hayakawa and I held hearings in this Committee to consider program levels for SBA's pollution control bond guarantee program. One of the more significant points brought out at that hearing was that large businesses have the ability to raise substantial amounts of capital through the issuance of IRB's. Witness after witness at that hearing, from the small businesses who have used the SBA guarantee program to the various state issuing authorities, to the panel of banks and underwriters, clearly stated that without the SBA guarantee and the IRB financing mechanism, small business would be without financing for that high-cost non-income producing pollution equipment.

The same results are true when small businesses utilize industrial revenue bonds to obtain affordable credit for other public purposes as well.

Nevertheless, some will argue that small businesses will benefit from the new tax bill. They point out that businesses will now have sufficient capital to finance their needs because of the reduction in tax rates and accelerated depreciation schedules. To the extent that small businesses have a "capital retention" problem, the tax bill may be of some marginal help. Unfortunately, the bill does not provide that "up front" money that small businesses need. The tax bill does not, and will not, improve small business access to capital for capital formation purposes. IRB's meet that need.

The Treasury Department's recent revenue ruling 81-216 will further hamper that capital formation process. This ruling prohibits issuance of multiple lots of $1 million revenue bonds and eliminates tax-exempt financing for small farmers. As a result, an important source of available credit will be severly restricted, while large corporations will still be able to use IRB's for many of their projects. Treasury's action, and the persistent rumors of their desire in totally eliminating the tax exempt feature of IRB's, regardless of their public purpose, seems at odds with the Administrations statements professing the importance of small businesses to the anti-inflation and economic recovery program.

While there have been abuses in the use of IRB's, they should be treated for what they are—abuses of an essentially sound financing tool. Already in this Congress, hearings have been held on these problems and legislation to correct them have been introduced in the House. But the overemphasis on problems has virtually denied us an opportunity to compare the significant benefits which this financing tool provides. Today's hearing is a perfect beginning to that long overdue review.

I look forward to today's testimony. It is my hope the Administration will be listening.

Senator D'AMATO. Because I recognize Senator Stevens' very busy schedule, I would ask my colleague, Senator Dixon, if he would waive his opening remarks so that we could have the benefit of Senator Stevens' testimony.

STATEMENT OF HON. THEODORE F. STEVENS, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator STEVENS. Thank you, Mr. Chairman.

It is a pleasure to appear before the committee and to offer my comments on the industrial revenue bond program and the recent actions taken by the Internal Revenue Service with respect to that program.

As you know, Mr. Chairman, since the early part of this century, income earned from bonds issued by State and local governments has been excluded from Federal taxation.

This mechanism we are talking about today—the tax-exempt bond issues, which are used to finance private enterprise—obviously has some problems.

Mr. Chairman, the lifeblood of small business is credit—both short-term credit and long-term expansion capital. No one needs to be reminded here today that business failures, especially among small businesses, are up over 40 percent from a year ago at this time. The reason is simply because of sky high interest rates.

The small businessmen are literally going bankrupt overnight because of the credit market.

When we have a business environment like this, the worst possible thing the Government could do would be to take away the industrial revenue bonds. It is one of the few tools cities and States have at their disposal to take economic devastation and turn it into economic development.

Yet this is precisely what the Treasury Department has for all practical purposes accomplished by the revenue ruling 81-216 which was issued August 29. It wipes out future umbrella bond programs.

The Department has since suspended the ruling and has agreed to take comments on it, but the fact is that a substantial threat to the future of the industrial revenue bond program remains. Yet we in Congress had no opportunity to discuss, investigate, or act on this matter before the administration decided to take its action.

I am sure that other witnesses will present the framework of the umbrella IRB programs in greater detail, but I want to point out what we have done in Alaska on this.

Alaska at the present time has one of the unfolding economies of the country because of our revenue picture and our resource potential.

We have what we call the Alaska Industrial Development Authority [AIDA] with an umbrella bond program. Before Revenue Ruling 81-216, Alaska could combine separate issues of up to $1 million bonds into a single umbrella bond issue sold with a single official statement and underwriting.

The savings from this combined offering allowed small borrowers access to the tax-exempt market at an even more affordable cost than if a separate statement and underwriting were done on each issue.

Because many of the small businesses did not have an adequate credit standing for the market, AIDA pledged its general assets, capital reserve funds, and the moral obligation of the State of Alaska to enhance the bond offering.

In Alaska, this program was restricted to industry, tourism, mining, and small businesses. No bond proceeds were used to purchase participations in loans to finance working capital, inventory, or the construction of speculative shopping centers or office buildings for which long-term leases had not been executed—complaints we have heard in other places.

I have a list of future commitments which AIDA will be allowed to go forward with under a grandfather letter ruling issued by the IRS for AIDA after Revenue Ruling 81-216 was released. The list virtually spans the entire spectrum of the small business in Alaska.

The Congressional Budget Office study reports that many small businesses were, in their estimate, credit worthy enough to obtain conventional financing in lieu of the IRB financing.

That assertion is untenable when many of the Alaska loan applicants I surveyed were, and still are, seeking very small loans. Sometimes they participated only to the extent of $20,000 in one of these issues.

Conventional financing would be at 22 percent if they could find it and qualify for it. Few, if any, could afford it.

The use of this tax-exempt bond to finance private enterprise began a long time ago. As a matter of fact, by 1936, the State of Mississippi authorized a modest program to aid a depressed agricultural economy.

By 1950, the program was catching on slowly. In the 1960's it had reached about $1.8 billion level.

The rise in these bond sales and the greater prominence of State and local efforts in this area led critics to charge that the bond programs were out of control. Several concerns were raised.

One was that public funds were being used to subsidize private activities that could have gained conventional financing. I think that is odd, particularly when that charge comes from those who maintain the high interest rates to prevent access to private financing.

Another was that the bonds were not targeted to depressed areas, and that was where the assistance was really needed.

Mr. Chairman, I could go on and on, but let me comment just briefly on the report of the Congressional Budget Office and the effect of revenue losses, unadjusted for reflow effects. They calculated if the program continued it would be $1 billion in 1981 and $2.9 billion by 1986.

However, CBO admits that the revenue loss projections are controversial, and that after adjusting for income reflow effects the annual revenue gain from completely eliminating the small issue IRB would be $700 million by 1986. That is significantly less than the unadjusted revenue loss.

The key to that, Mr. Chairman, is that they also have not calculated what I would call the domino effect. This is the problem that when these small businesses go out of business in Alaska, their people have to go on welfare or unemployment compensation. They have not looked into the redundant effect upon the Federal budget from the failure of this program if it is shut off.

I do not want to criticize the CBO. They did a good job in their IRB study. However, it seems to me that too much attention was focused on IRB abuses. They should have looked at the benefits of IRB's rather than just abuses.

I would hope that this committee would do that—that it would find some way to quantify what is the cost to the Federal Government of these small businesses not being able to have access to financing at all, because this is their last hope.

If the IRB's are shutoff, they will, in fact, all be eliminated from the scene in a State such as mine.

It is my feeling, and I hope it is the sentiment of the Congress, that we should let the States define how and when lowering of borrowing costs of private industry is in the public interest.

It's true that the Revenue Expenditure and Control Act may need some adjustment, but it is vitally important to me that we continue this financing option for local governments, and that we eliminate these hurdles set up by the Treasury Department.

I am hopeful that the President will not recommend the termination of the IRB's. I understand that his proposals may appear in the second tax measure which we expect to receive yet this session.

I am optimistic that he will recognize this as a tax option, which should be maintained. I think that there ought to be firm support from the Congress forthcoming to let him know that we would welcome such a recommendation.

Thank you very much, Mr. Chairman.

Senator D'Amato. Thank you, Senator Stevens.

I commend you and our chairman, Senator Weicker, for your outstanding leadership in calling Revenue Ruling 81-216 to our attention early on and stating your objection to it.

I concur and am somewhat at a loss to understand why Treasury is not here today. They were advised of the hearing.

I believe that they feel that doing business as usual in their manner, regardless of what the facts are or what the feeling of Congress is, is the answer to today's economic problems.

I think that they should be here to listen to some of the testimony of the public officials, such as yourself, and those on the battleline so to speak—back in the States and the counties and local parishes which have to deal with these problems—the small business entrepreneur who is struggling for survival.

Indeed, in many cases, the only source of new capital has been the industrial revenue bonds that have been made available under this program.

Senator Stevens. I hope that your committee will give them a second opportunity to appear, because I am sure that some of us will assist you in getting the word downtown that they ought to appear.

I did not know that they were not going to appear today. I thought they would.

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I appreciate your time, and I would appreciate it if you would print my statement in full in the record.

Senator D'AMATO. It will be made a part of our hearing record in its entirety.

[The prepared statement of Senator Stevens follows:]

INDUSTRIAL REVENUE BONDS

Remarks of Senator Ted Stevens

before the

Committee on Small Business
Subcommittee on Urban and Rural Economic Development

UNITED STATES SENATE
Washington, D.C.

October 5, 1981

Mr. Chairman: It's a pleasure to appear before the Committee today to offer my comments on the Industrial Revenue Bond Program and recent actions taken by the Internal Revenue Service with respect to that program.

As you know, Mr. Chairman, since the early part of this century income earned from bonds issued by state and local governments has been excluded from Federal taxation. Local governments have utilized this device to finance their many needs, and over the years we have seen the modern state and municipal bond markets become an important segment of our economy. A part of this growth has included Industrial Revenue Bonds, or I.R.B.'s. These are, of course, tax exempt bond issues which are used to finance private enterprise.

Today I'm not here to tell about the problems with small issue I.R.B.'s. This Committee and others in Congress may have to address some reforms in I.R.B.'s. I'm here to tell you why 47 states, including my own home state of Alaska, have such programs.

Small issue I.R.B.'s are one of the best opportunities that the Federal government can provide to state and local governments to fashion their own economic development. Today, we are cutting back on direct Federal aid to state and local governments in a painfully short period of time. Our message to local governments seems to be a clear one; you will have a greater responsibility for taking care of your own local problems.

Many current periodicals are reporting on how local governments are struggling to provide even the most essential services to their citizens. Newsweek reports that Chicagoans have seen a recent penny rise in sales taxes, a five cent climb in cigarette levies, plus a new one percent tax on services. With the cutback in Federal support, it's apparent cities need to broaden their tax bases; only through economic decelopment can that become possible.

Mr. Chairman, the lifeblood of small business is credit -- both short term credit and long term expansion capital. No one here needs to be reminded that business failures, especially among small businesses, are up over 40 percent from a year ago at this time. The reason is because of sky high interest rates. Small businessmen are literally going bankrupt overnight because of the credit market. When you have a business environment like this, the worst possible thing you can do is to take away Industrial Revenue Bonds. They're one of the few tools cities and states have at their disposal to take economic devastation and turn it into economic development.

Yet, this is precisely what the Treasury Department has for all practical purposes accomplished by revenue ruling 81-216 that was issued on August 29, 1981, which wipes out future Umbrella bond programs. The Department has since agreed to have the ruling commented upon, but it remains a substantial threat to future I.R.B. programs, and we in Congress have had no opportunity to discuss, investigate and act on this matter before the Administration decided to take its action.

Mr. Chairman, other witnesses will present the framework of Umbrella I.R.B. programs in greater detail, but I can't underscore the importance enough of these financing devices for small businesses. The prime rate is currently running at about 20 percent. Small businesses usually pay two percentage points above that. Obviously, most of them can no longer participate in the credit market. Most I.R.B. programs can make loans of anywhere from one-half to sixty percent of the rate small businesses must conventionally pay. Many state programs can provide other benefits. AIDA, Alaska's Industrial Development Authority, has an Umbrella bond program that before Revenue Ruling 81-216 could combine separate issues of up to $1 million bonds into a single umbrella bond issue, sold with a single official statement and underwiritng. The savings from this combined offering allowed small borrowers access to the tax exempt market at an even more affordable cost than if a separate statement and underwriting were done for each issue. Further, because small businesses do not have adequate credit standing for a market issuance, AIDA pledges its general assets, capital reserve fund, and the moral obligation of the state of Alaska to enhance the bond offering.

In Alaska, the I.R.B. program is restricted to industry, tourism, mining and small businesses. No bond proceeds are used to purchase participations in loans to finance working capital, inventory or the construction of "speculative" shopping centers, or office buildings for which long term leases have not been executed.

I've been provided a list of the future commitments that AIDA will be allowed to go forward with under a "grandfather" letter ruling issued by the IRS for AIDA after Revenue Ruling 81-216 was released. The list virtually spans the entire gambit of small business in Alaska. The Congressional Budget Office study reports that many small businesses were, in their estimate, credit worthy enough to obtain conventional financing in lieu of I.R.B. financing. That assertion is untenable when many of the Alaska loan applicants I surveyed were, and are, seeking very small loans, sometimes as low as $20,000.00. Conventional financing would be at 22 percent if they could find it and qualify for it, and I'm sure few, if any, could afford it.

Mr. Chairman, the popularity of these bonds can be illuminated by their historical development. The use of a tax exempt bond to finance private enterprise had its roots in the mid part of this century. In 1936 the State of Mississippi authorized a modest program to aid a depressed agricultural economy. Thus the appearance of an industrial revenue bond or I.R.B.

By 1950 the idea had not caught on, and only two other states, Alabama and Kentucky, had I.R.B. programs. After that year, the attractiveness of the concept did grow and by 1950, 17 states had I.R.B. programs. Between 1960 and 1968 the annual volume of reported I.R.B. sales climbed sharply from $100 million to $1.8 billion.

The rise in these bond sales and the greater prominance of state and local efforts in this area led critics to charge that the bond programs were out of control. Several concerns were raised. One was that public funds were being used to subsidize private activities that could have gained conventional financing. Another was that the bonds were not targeted to depressed areas that really needed assistance.

A further concern was that the bond's proliferation raised the cost of conventional tax exempt bonds. Finally, of course, was the objection to the revenue loss. This growth of a revenue loss did not escape the attention of the Treasury, which in 1968 proposed regulations to eliminate these tax exempt issues. Then, as now, Congress stepped in and after some deliberation passed the law which currently governs I.R.B.'s: The Revenue Expenditure and Control Act. The Act limits the use of the bonds to funding of public facilities, or to finance any private project in an amount not exceeding one million dollars. Additionally, amounts up to $10 or $20 million were authorized, depending on whether UDAG funding were also involved, and if each project complied with capital expenditure limitations.

The Act imposed no other limitations on who could qualify for funding, nor on the total amount of bonds that could be issued by any one local agency. The states were left free to fashion their own qualifications and limitations for each program. Today, 47 states issue I.R.B.'s. Less than half put restrictions on the bond's proceed use. The growth of the bond sales has been phenomenal, and this year it is reported by the Congressional Budget Office to be $8.4 billion. The effects on the Federal revenue losses, unadjusted for reflow effects, are calculated by the CBO to be $1 billion in 1981 and $2.9 billion by 1986. However, even the CBO admits that revenue loss projections are controversial and that after adjusting for reflow effects the net annual revenue gain from completely eliminating small issue I.R.B.'s would be $700 million by 1986, significantly less than the unadjusted revenue loss.

I don't want to criticize the CBO. I think they did a good job in their study on I.R.B.'s. Yet, in their study, more attention seemed to be focused on I.R.B. abuses rather than public benefits garnered by the issuance of the bonds.

It's my feeling, and I hope the sentiment of this Congress, that we should let the states define how and when lowering the borrowing costs of private industry are in the public interest. The Revenue Expenditure and Control Act may need some fine tuning, but in my judgment it is vitally important we continue this financing option for local government and that we eliminate the recent hurdles set up by the Treasury Department for continuing the Umbrella Bond programs.

The President is apparently studying whether he will recommend a termination to I.R.B.'s. His proposals will probably appear in the tax measures he intends on sending to the Finance Committee in the next two or three weeks. I'm optimistic that he will recognize that this is a tax option, which should be maintained, although I don't doubt there is some room for improvement in the Expenditure Act.

Thank you, Mr. Chairman, for allowing me the opportunity to appear before the Committee today. I'll be happy to respond to any questions that you may have.

Senator D'AMATO. Senator Weicker, do you have a comment to make?

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator WEICKER. I am delighted to see Senator Stevens here, because there is no more effective Senator for getting everything for the State of Alaska. What they do not have under the ground, Senator Stevens gets for them here in Washington. [Laughter.]

I figure with his backing we stand a chance with the administration.

I have an opening statement which I would include in the record at this point.

[The prepared statement of Senator Weicker follows:]

OPENING STATEMENT BY SENATOR LOWELL WEICKER, JR., HEARING BEFORE THE SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT SENATE SMALL BUSINESS COMMITTEE

October 5, 1981

Today, the Urban and Rural Economic Development Subcommittee, chaired by my colleague, Senator D'Amato of New York, will be examining a question of continuing interest to this Committee: Access to capital for small businesses. The Subcommittee will be looking at the importance of tax-exempt financing in the promotion of local economic development through small businesses.

The recent action of the IRS in changing the rules of the game in midstream, and, more recently, the President's message implying that the tax-exempt industrial development bond program may be eliminated as a part of his plan to generate Federal revenues, have once again shut the door on small business.

On August 24, 1981, the Internal Revenue Service precipitately issued revenue ruling 81-216, which would prohibit issuance of multiple lots of one million dollar tax-exempt agricultural and industrial development bonds. This ruling was one of the most counterproductive, wrong-headed, ill-timed and ill-conceived actions I have seen in my tenure as a U. S. Senator. On September 17, along with Senators Durenburger, Stevens, D'Amato and others, I introduced S. 1635, to postpone the effective date of revenue ruling 81-216 until January 1, 1983. We also wrote to Treasury Secretary Regan urging him to postpone the ruling.

I believe this is a most inauspicious time for assaulting the IDB program.

(MORE)

INTEREST RATES ARE AT AN ALL-TIME HIGH FOR SMALL BUSINESSES; CONVENTIONAL SMALL BUSINESS AND AGRICULTURAL DEVELOPMENT ASSISTANCE IS BEING SHARPLY CURTAILED; AND GREATER RELIANCE IS BEING PLACED ON STATE GOVERNMENTS FOR LOCAL ECONOMIC DEVELOPMENT. FARMERS AND SMALL BUSINESSES, THE FRONT LINE TROOPS IN THE ANTI-INFLATION BATTLE, ARE ALREADY BEING DEVASTED BY HIGH INTEREST RATES. THIS RULING WOULD MAKE MATTERS MUCH WORSE.

THIS ACTION REVERSES A 9-YEAR PRACTICE AND REVOKES THREE PREVIOUS REVENUE RULINGS ALLOWING STATES TO ISSUE THESE AGRICULTURAL AND INDUSTRIAL BONDS. A POLICY CHANGE OF THIS MAGNITUDE OUGHT TO BE CONSIDERED AND DECIDED BY THE CONGRESS.

WHILE THIS ACTION CAUGHT SEVERAL STATES WITH COMMITMENTS IN THE PIPELINE, THE IRS HAS GRANTED SOME STATES EXEMPTIONS BY "GRANDFATHERING" THOSE LOANS SO THAT EXPANSION CAN TAKE PLACE AS PLANNED. THIS DOES NOTHING, HOWEVER, TO ADDRESS THE LONG-TERM POLICY CONSEQUENCES OF THIS COUNTERPRODUCTIVE RULING.

FINALLY, IN THE FIRST ROUND OF BUDGET CUTS, THE ADMINISTRATION PROPOSED ENTERPRISE ZONES AS THE ANSWER TO LOCAL ECONOMIC DEVELOPMENT PROBLEMS. THE ENTERPRISE ZONES CONCEPT, WE WERE TOLD, WOULD SPUR BUSINESS ACTIVITY IN DISTRESSED AREAS THROUGH FEDERAL TAX ABATEMENT. NOW WE ARE TOLD THAT A TOOL THAT STATES HAVE VERY EFFECTIVELY USED TO PROMOTE SMALL BUSINESS AND LOCAL ECONOMIC DEVELOPMENT THROUGH TAX ABATEMENT, I.E., TAX-EXEMPT INDUSTRIAL DEVELOPMENT BONDS, WILL BE DISCONTINUED. LAST WEEK THE PRESIDENT SUGGESTED THE ELIMINATION OF TAX-EXEMPT IDB'S AS A MEANS OF RAISING REVENUES. THE IRS RULING AND THE PRESIDENT'S STATEMENT LAST WEEK CONTRADICT ALL OF THE PRINCIPLES WE'VE HEARD ESPOUSED IN CONJUNCTION WITH ENTERPRISE ZONES OVER THE PAST FEW MONTHS.

I COMMEND SENATOP D'AMATO FOR CALLING THIS HEARING TO CONSIDER AND EXPLORE THIS VERY IMPORTANT AND TIMELY ISSUE.

*****

Senator **Weicker**. I would like just to summarize my feelings to this extent:

Small business as well as "small" individuals, are just getting belted all over the ring by the economic policy of the administration.

In this committee my responsibility, along with Senator D'Amato and Senator Dixon, is to look at the impact of these policies on small business.

Those businesses that are not getting knocked out by economics are getting bought up by big business.

Delaying the implementation of actions like Revenue Ruling 81-216, is certainly one way, without the enactment of any new legislation, that we can assist the small business owner with his particular problems at this time.

It would be my hope, Senator, that your subcommittee would take quick action on this matter and get it out there on the floor. I would hope that something could be done administratively, but I doubt that.

I know one thing. Whatever is going to be done has to be done right now—otherwise there is no point in going through this exercise.

Hopefully, the penalizing effects of Treasury's actions are not going to continue ad infinitum.

I certainly want to assure you and the members of the subcommittee that I will do what I can to have the full committee support your efforts.

[Subsequent information was received and follows:]

DAY, BERRY & HOWARD
COUNSELLORS AT LAW
ONE CONSTITUTION PLAZA
HARTFORD, CONNECTICUT 06103
TELEPHONE (203) 278-1330
TELEX 99324

THREE LANDMARK SQUARE
STAMFORD, CONNECTICUT 06901
TELEPHONE (203) 348-3840

October 15, 1981

Senator Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Senator Weicker:

Your Committee's recent hearing on the Treasury's attempt to deny tax-exempt treatment to combined issues of industrial aid bonds may have failed to highlight an important difference between run-of-the-mill conduit financings and programs in which the governmental issuer offers its own credit as additional security for the bonds. The State of Connecticut has such a program known as the Connecticut Development Authority's umbrella program. This is a State-backed industrial aid program which should be preserved and protected even if other programs for combining tax-exempt small issues are stopped, either through operation of Treasury's new proposed regulations taking the place of the recently withdrawn Revenue Ruling 81-216, or through new legislation enacted by the Congress.

The persons testifying at the Committee hearing may have failed to point out an important distinction among the types of composite issues swept up by Revenue Ruling 81-216. I suggest that the presence or absence of State backing should be an important consideration in determining whether or not such programs should continue to receive favorable tax-exempt treatment. I urge that your Committee look seriously at this distinction when considering the composite issue question attacked by Revenue Ruling 81-216. The "common security" in the CDA umbrella program is provided both by CDA and by the State itself, having decided as a matter of State policy to come forward to offer its own credit as part of a State program to assist small businesses in Connecticut. It is entirely different from "common security" furnished by the business borrower, as when a parent company guarantees indebtedness of subsidiaries, affiliates or franchises.

Under the Connecticut Development Authority's umbrella program the loans made from the proceeds of the tax-exempt bonds issued by CDA are insured by the State's Industrial Building Mortgage Insurance Fund created pursuant to Section 32-14 of the General Statutes. Under Section 32-22 of the General Statutes the State Bond Commission is obligated to issue State general obligation bonds in amounts necessary to make good on the commitments of the Mortgage Insurance Fund. The expected source of payment of the CDA bonds are the mortgage payments received from the business borrower but the State of Connecticut has put its credit on the line by insuring the mortgage payments. This creates a claim on the taxing power of the State.

Secondly, and separate from the State's insurance commitment, bonds issued by the Connecticut Development Authority are further secured by the State's obligation to make up any deficit in the special capital reserve fund which is initially funded from bond proceeds and is set aside and available to pay debt service on the CDA bonds in the event that the project revenues, e.g., mortgage payments from the business borrower, are insufficient. Section 32-23j of the General Statutes provides in effect that if the bond trustee has to dip into the special capital reserve fund in any year in order to make principal and interest payments on the CDA bonds because of a shortfall in project revenues, the State will make up the deficit in such reserve fund in the following year. This creates another claim on the taxing power of the State.

Thus, bonds issued by CDA for its umbrella program are doubly secured by a claim on the State's taxing power, first through insurance of mortgage payments and, second, through the obligation to make up any deficit in the capital reserve fund. The umbrella program is not just a conduit for conferring tax-exemption on small business borrowers but is instead a State-backed business assistance program. It would be both ridiculous and unfair if the State backing for this program became the "common security" which the Treasury identifies as the reason for denying tax-exemption but that is just what Revenue Ruling 81-216 and the new proposed regulations purport to do. At the very least, a true State-backed industrial assistance program, such as CDA's umbrella program, should be encouraged to continue to operate, even if other "common security" composite issues are denied tax-exempt treatment in cases where the common security feature comes from the business borrower's side of the table.

Senator Lowell P. Weicker, Jr.
Page Three
October 15, 1981

The fact that CDA umbrella bonds are backed by claims against the taxing power of the State means that the State Treasurer and other officers responsible for insuring the State's access to the financial markets will exercize a monitoring role on the type and amount of CDA bond issues. This will have the expected result of rationing the amount of such bonds and diminishing the impact on the tax-exempt market.

If Congress determines that steps should be taken to limit or prohibit combined tax-exempt small issues because they are not, in fact, "small issues", it should distinguish between simple conduit financings and financings which are part of a State-backed industrial aid program involving and pledging the taxing power of the State.

Very truly yours,

Isaac D. Russell

Isaac D. Russell

IDR/pl

cc: Richard L. Higgins
Executive Director
Connecticut Development Authority

Senator D'Amato. Senator Dixon?

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator Dixon. Thank you, Mr. Chairman.

First, I want to compliment you, Mr. Chairman, as the chairman of this Subcommittee on Urban and Rural Economic Development and also the chairman of the full committee, Senator Weicker, for so expeditiously scheduling these important hearings on the importance of continuing access to industrial revenue bonds for small farm and nonfarm businesses.

The general decline in the national economy, coupled with increasing business bankruptcies and the shrinking small business base, has placed a severe strain on the treasuries of State and local governments.

When used properly, these tax-exempt bonds help save businesses; they help save jobs; they help to finance needed expansion and plant modernization; they contribute significantly to the economic growth and development of many of our communities.

Almost all of this is done, Mr. Chairman, by the private sector.

I ask that the balance of my remarks, Mr. Chairman, be included in the record as though read in full.

Senator D'Amato. It is so ordered.

[The material follows:]

Although the statutory authority for tax-exempt industrial revenue bonds has been in existance for some time, their widespread use did not begin until 1979 when interest rates began rising rapidly and the small business' access to capital diminished. This financing mechanism has proven to be a valuable lifeline to the small business and agricultural communities in general, and in particular to those small businesses that have been forced to install necessary, but expensive, nonincome producing, environmental controls.

As in so many other areas, the individual financing requirements for small businesses are too small for the financial institutions to "bother." Direct access to the bond market for these amounts, and, therefore, for these businesses, is simply out of the question. But by pooling their needs, and sharing the costs of documents, bond counsel, and fees small businesses can gain that vital access to the financial markets at reasonable rates.

Simply, these bonds perform a critical role by ending the discrimination which small businesses face in trying to find affordable capital to meet their needs.

The President is calling for an increased reliance on the private sector. With very few exceptions, this entire program is done without the need for Federal employees. The States identify the needs the financing authorities issue the inducement resolution and the bonds; private bond counsel provide a review of the legal sufficiency of the documents and an opinion as to the bond's tax-exempt status; the issuing authority or a private underwriter markets the bonds to the private financial markets; the small business gets their funds to increase their private sector operations. Nowhere is the Federal Government involved.

Even in the Small Business Administration's pollution control bond guarantee program, a program this committee carefully reviewed only five months ago, we learned that the preponderance of the work is done in the private sector. SBA's two employees primarily insure that the Federal statutory requirements are complied with before an SBA guarantee does place the Federal Government under a contingent liability, there has not been a single loss in the five years of that program. In fact, the initial capital that Congress provided for the SBA revolving fund in 1976 has doubled through fees and SBA investments.

I would hope that the administration would carefully review the benefits that this entire program has demonstrated. In my view, the ability to offer small businesses a viable financing alternative at reasonable costs should not easily be dismissed.

Problems with the utilization of tax-exempt bonds have been identified by Treasury, and various congressional studies and hearings. These must be addressed, and, where necessary, corrected. But these "abuses,' if that is what they are, are miniscule compared to the benefits to small businesses, State and local governments, and the national economy, that these bonds provide.

Mr. Chairman, there is no question that the Treasury loses some revenue because of the tax-exempt feature of these bonds. But the elimination of the tax exemption does not insure that the funds "lost" through these types of issues will automatically begin flowing into Treasury's pockets, as some have suggested. On the contrary, the Congressional Budget Office, in their comprehensive study of IRB's cautions that Treasury may not receive any significant return by the elimination of the tax-exemption. The reasons seem fairly obvious. Investors who need the income shelter that these tax-exempt bonds provide will likely seek other tax shelters. Furthermore, not all of the bond holders are themselves taxable entities regardless of the tax-exempt status of the bonds.

Treasury does not seem to take these factors into consideration, nor to account for any "reflows" to the Treasury which providing this source of capital to the small business sector provides.

I look forward to the testimony of today's witnesses, and to the committee's future positive actions regarding these programs.

Senator D'AMATO. We have as our next witness Congressman Berkley Bedell. Congressman Bedell is from Iowa and is now serving in his fourth term in the House of Representatives.

He comes to the committee to testify having himself been a successful small business entrepreneur.

He serves on the Agriculture Committee in the House and is the chairman of the House Small Business Committee's Subcommittee on Energy, Environment, and Safety.

Good morning, Congressman.

STATEMENT OF HON. BERKLEY BEDELL, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA, AND CHAIRMAN, SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND SAFETY ISSUES AFFECTING SMALL BUSINESS OF THE HOUSE COMMITTEE ON SMALL BUSINESS

Representative BEDELL. Thank you, Senator.

I would like to shorten my testimony, if I might, and ask that the entire testimony be entered in the record.

Senator D'AMATO. Without objection, it will be included in the record at the completion of your oral testimony.

Representative BEDELL. First of all, I want to commend you for your timely action in holding these hearings.

Revenue Ruling 81-216, as you know, makes it virtually impossible to issue aggregated or bundled lots of small tax-exempt bonds.

This seriously undermines the efforts of many States to help finance economic development plans involving small business. It wrecks efforts by several States, including my home State, to assist family farmers. It brings to a halt the efforts of many State and local government agencies to help smaller firms finance pollution abatement equipment. It does violence to the concept of New Federalism that has been put forward by the President.

Mr. Chairman, I will expand on all these points in just a moment but first I want to tell you that my main purpose in coming here this morning is to convey to you the strong sentiment in the House in opposition to Revenue Ruling 81-216.

Last week I sent a letter to Secretary of the Treasury Donald Regan which was signed by two dozen representatives. Divided equally between the two parties, the list of signers included the chairman of the bipartisan congressional rural caucus and the chairman and ranking minority members of the Small Business Committee.

In looking over your list of witnesses for today's hearing, it seems you will be receiving a great deal of testimony on how small-issue tax-exempt bonds are used to help small businesses and local economic development. Consequently, I will not use my time here to discuss that issue.

Instead, I will talk about two less well-known subjects—agricultural development and pollution control financing. Both of these areas have benefited greatly from small-issue bonds in recent years. Both are severely adversely impacted by Revenue Ruling 81-216.

Just in the past 2 years or so, 18 States have established development bond financing programs for agriculture. These programs are vital to their efforts to assist the small farmers to survive in the current financial climate.

In my home State of Iowa, just last year the legislature established a program to assist and encourage family farmers. It was to have started later this year, using aggregated small-issue bonds as the principal financing mechanism.

I recently received a letter from Mr. George Schneiderman, a constituent of mine and the vice-chairman of the Iowa Family Farm Development Authority. In this letter, he explains how the Treasury Department's recent action sabotages Iowa's efforts to help the small farmer.

In checking with officials in other States, we find similar problems arising throughout the Nation.

The Revenue Ruling 81-216 brings to a grinding halt numerous efforts to help small businesses finance the pollution control equipment that is required by Federal and State programs.

In the past, when a small firm sought financial help to install expensive pollution abatement equipment, it had two possible sources of assistance. The first was pollution control bonds issued by State or local authorities pursuant to Federal law. When issued in small denominations to help smaller businesses, these often came out in aggregated offerings which now have been ruled out by the Treasury Department.

The second option was to turn to the Small Business Administration for the nonphysical disaster and pollution control loan programs the SBA administered. Of course, we know that the nonphysical disaster loan program was eliminated in the first round of budget cuts earlier this year.

The pollution control loan guarantee program increasingly has come to be used in tandem with small-issue, tax-exempt bonds.

Therefore, small businesses that need financial help in order to comply with Federal or State environmental protection requirements have been effectively barred from using the two programs that are there to help them.

This dilemma is spelled out in a letter I received recently from Mr. Ronald Bean, president of the Council of Pollution Control Financing Agencies.

That letter, written on behalf of 19 State and local pollution control financing authorities, brings us to my final point.

In his letter, Mr. Bean says, and I quote:

> I must also comment on the unbending response of the administration to the appeal of a delegation of Governors who met with the President and voiced their concern over the ruling. After being told the ruling would be withdrawn, they later learned that it is being replaced by a proposed regulation, backdated to August 24, so that the freeze will continue in effect throughout the period of proposal and comment.

Mr. Chairman, how on earth are the State and local governments supposed to assume all of the new responsibilities being thrust upon them these days if the Treasury Department is going to spend its time running around figuring out new ways to deny them the financial tools they need to implement their plans? I understand that the Treasury Department has proposed making some cosmetic changes in their ruling. We should be careful not to be taken in by their fancy footwork.

The bottom line here is money. If the State and local authorities are not allowed to use the financing mechanisms Congress has already provided them, then they cannot help small businesses, family farmers, and the environment.

It is my hope that this hearing and the letters we have sent and the bills that have been introduced all combine to convince the Treasury Department of the error in its ways.

If they do not and the bureaucrats over there do not voluntarily correct their course, then I believe the Members of the House stand ready to join our colleagues in the Senate in taking such legislative actions as may be necessary to remedy this situation.

Thank you very much for the opportunity to be here, Mr. Chairman.

Senator D'AMATO. Thank you, Congressman, for being here and for giving your strong words of support for what I believe will be necessary.

Unfortunately, I do not believe that the bureaucrats will change their ways. Rather, they are more inclined to dictate to Congress what they think the law should be, regardless of what legislative intent has been.

Consequently, I have an ominous feeling that they are lurking, ready to expand the damage that has already taken place as a result of their banning the umbrella use of the small issues, which, as you know, in many cases totally cuts off the small entrepreneur and the small farmer from any help or any remedy.

I would like to know how we save money when that small farmer cannot go out and make the kinds of acquisitions, purchases, and investments he needs. Eventually, as a result of the lack of productivity because he can no longer compete, he closes that farm or business and pays no taxes and employs no one. Where are the figures to indicate the tremendous financial and economic savings from the harm that we do to that individual and to our society as a whole?

I am delighted to hear of your strong feeling for this. I can tell you that Chairman Weicker, Senator Dixon, and I also feel very strongly about this matter.

Thank you for coming.

Representative BEDELL. Mr. Chairman, several States have enacted legislation to help beginning farmers start farming. Minnesota has a tremendously successful program. There are some 18 States with such programs. Iowa has recently enacted legislation to set up their program.

Those programs really depend upon these revenue bonds in order to be successful.

To some extent, if we are going to make family farming attractive to new farmers, this becomes quite critical in many States.

Senator D'AMATO. Are there are any questions of Congressman Bedell?

Senator WEICKER. I would get ready. Senator D'Amato and I agree that we are not going to wait on the administration.

Senator D'AMATO. We look forward to a coordinated effort in a very bipartisan way to address what we think is a very serious threat to the small business community, both urban and rural.

I might add that there are many businesses in the urban area that, without this kind of help, would not even begin to contemplate expansion.

It is not only the rural area but the urban as well.

Here is an opportunity for us to bring both constituencies together. I look forward to working with you on this.

Representative BEDELL. Thank you, Senator.

[The prepared statement of Representative Bedell follows:]

BERKLEY BEDELL
6TH DISTRICT, IOWA

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Congreſs of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE:
2440 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515
(202) 225-5476

SIOUX CITY OFFICE:
316 FEDERAL BUILDING
SIOUX CITY, IOWA 51101
(712) 233-3331

FORT DODGE OFFICE:
479 FEDERAL BUILDING
FORT DODGE, IOWA 50501
(515) 573-7169

Remarks by

CONGRESSMAN BERKLEY BEDELL

Before the

Senate Small Business Committee

Subcommittee on Urban & Economic Development

October 5, 1981

Mr. Chairman, I commend you and the members of this committee for your timely action in convening this hearing. It is just over a month now since the Treasury Department issued revenue ruling 81-216, and it is not a moment too soon for the Congress to set about undoing the damage that ruling is causing.

The ruling, as you know, makes it virtually impossible to issue aggregated or bundled lots of small tax-exempt bonds. This seriously undermines efforts by many states to help finance economic development plans involving small businesses. It wrecks efforts by several states, including my home state of Iowa, to assist family farmers. It brings to a halt the efforts of many state and local government agencies to help smaller firms finance pollution abatement equipment. And it does violence to the concept of New Federalism that has been put forward by the President.

Mr. Chairman, I will expand on all of these points in just a moment. First, though, I want to tell you that my main purpose in coming here this morning is to convey to you the strong sentiment in the House in opposition to revenue ruling 81-216 or any similar ploy by Treasury Department officials to shut down the small issue revenue bond program.

Last week I sent a letter to Secretary of the Treasury Donald Regan that was signed by two dozen Representatives. Divided equally between the two parties, the list of signers includes the chairman of the bipartisan Congressional Rural Caucus (Wes Watkins) and the chairman (Parren Mitchell) and ranking minority member (Joe McDade) of the Small Business Committee. A copy of our letter is included as an appendix to my statement.

In looking over your list of witnesses for today's hearing, it seems you will be receiving a great deal of testimony about how small-issue,tax-exempt bonds are used to help small businesses and local economic development. Consequently, I will not use my time here to discuss that issue. Instead, I will talk about two less well-known subjects: agriculture development and pollution control financing. Both of these areas have benefited greatly from small-issue bonds in recent years, and both are severely adversely impacted by revenue ruling 81-216.

cont'd

Just in the past two years or so, eighteen states have established development bond financing programs for agriculture. With bank loan interest rates remaining at near-record high levels, and with traditional federal assistance programs being sharply curtailed, the states see these programs as being vital to their efforts to assist the small farmer survive in the current financial climate.

In my home state of Iowa, the legislature just last year established a program to assist and encourage family farmers. It was to have started up later this year, using aggregated small-issue bonds as the principal financing mechanism.

As an appendix to my statement, Mr. Chairman, I have attached a copy of a letter I received recently from Mr. George Schneiderman, a constituent of mine and the vice chairman of the Iowa Family Farm Development Authority. In this letter, he explains how the Treasury Department's recent action sabotages Iowa's efforts to help the small farmer. In checking with officials in other states, we find similar problems arising throughout the nation.

In the area of pollution control, the impact is even more drastic. Revenue ruling 81-216 brings to a grinding halt numerous efforts to help small businesses finance the pollution control equipment that is required by federal and state programs to improve the quality of the environment.

cont'd

In the past, when a small firm sought financial help to install expensive pollution abatement equipment, it had two possible sources of assistance. The first was pollution control bonds, issued by state or local authorities pursuant to federal law. When issued in small denominations to help smaller businesses, these often came out in aggregated offerings -- which now have been ruled out by the Treasury Department.

The second option was to turn to the Small Business Administration for the non-physical disaster and the pollution control loan guarantee programs the SBA administered. Of course, we know that the non-physical disaster loan program was eliminated in the first round of budget cuts earlier this year. And the pollution control loan guarantee program increasingly has come to be used in tandem with small-issue, tax-exempt bonds.

So, small businesses that need financial help in order to comply with federal or state environmental protection requirements havebeen effectively barred from using the two programs that are there to help them. This dilemma is spelled out in a letter I received recently from Mr. Ronald Bean, president of the Council of Pollution Control Financing Agencies. A copy of that letter is included as an appendix to my statement.

cont'd

That letter, written on behalf of 19 state and local pollution control financing authorities, helps bring us to my final point. In his letter, Mr. Bean says:

> I must also comment on the unbending response of the Administration to the appeal of a delegation of governors who met with the President and voiced their concern over the ruling. After being told the ruling would be withdrawn, they later learned that it is being replaced by a proposed regulation, backdated to August 24, so that the freeze will continue in effect throughout the period of proposal and comment.

Mr. Chairman, how on earth are the state and local governments supposed to assume all of the new responsibilities being thrust upon them these days if the Treasury Department is going to spend its time running around figuring out new ways to deny them the financial tools they need to implement their plans? This is hardly an auspicious start for the President's New Federalism program.

Perhaps we should not be surprized by all this. After all, the concept that the President giveth and the Treasury Department taketh away is not a new one.

What is most disturbing to me, however, is that the Treasury Department has embarked on this course of action -- which is very disruptive of ongoing state and local programs-- without any effort to consult the affected state and local governments. In fact, they appear to have acted in blatant disregard of their concerns.

I understand that the Treasury Department has proposed making some cosmetic changes in their new ruling. We should be careful not to be taken in by their fancy footwork.

The bottom line here is money. If the state and local authorities are not allowed to use the financing mechanisms Congress has already provided to them, then they cannot help small businesses, family farmers and the environment.

It is my hope that this hearing, and the letters we have sent, and the bills that have been introduced, all combine to convince the Treasury Department of the error of its ways. If they do not, and the bureaucrats over there do not voluntarily correct their course, then I believe the members of the House stand ready to join our colleagues in the Senate in taking such legislative actions as may be necessary to remedy this situation.

Congress of the United States
House of Representatives
Washington, D.C. 20515

September 30, 1981

Hon. Donald T. Regan
Secretary of the Treasury
15th & Pennsylvania Ave.
Washington D.C., 20220

Dear Mr. Secretary:

This is to request that you rescind Revenue Ruling 81-216. That ruling has the effect of prohibiting the issuance of multiple lots of small issue tax-exempt industrial and agricultural development bonds.

A number of states have established agencies which issue "umbrella" bonds to assist small businesses and family farmers. Interest on the bonds is tax-exempt, and the proceeds are used to make low interest loans to individual farmers and small business owners. With commercial interest rates at record high levels and with conventional development assistance to small business and agriculture being sharply curtailed, state and local governments must bear an increasing responsibility for economic development. Consequently, we are distressed by Revenue Ruling 81-216 which makes this task much more difficult for the state and local authorities.

We are, of course, troubled by reports that industrial revenue bonds may have been used to benefit certain large coporations that were not intended to be in the program. However, it appears that Revenue Ruling 81-216 is overly broad in its scope, precluding the use of aggregated small issue revenue bonds to help the smaller enterprises the program was established to assist.

Therefore, we respectfully request that the rule be withdrawn. If changes in the industrial revenue bond program are in fact required, they should be much more limited in scope and not cause major disruptions of on-going efforts by the states to aid small businesses and family farmers.

Sincerely,

Berkley Bedell
Berkley Bedell, M.C.

John J Duncan
John Duncan, M.C.

Wes Watkins
Wes Watkins, M.C.

(more)

George Hansen
George Hansen, M.C.

Arlan Stangeland
Arlan Stangeland, M.C.

Wm Broomfield
William S. Broomfield, M.C.

Cooper Evans
Cooper Evans, M.C.

Richard Ottinger
Richard L. Ottinger, M.C.

Ron Wyden
Ron Wyden, M.C.

James Nelligan
James L. Nelligan, M.C.

Lawrence Coughlin, M.C.

Thomas J. Tauke
Thomas J. Tauke, M.C.

Matthew F. McHugh
Matthew F. McHugh, M.C.

JoeMcDade
Joseph M. McDade, M.C.

Barney Frank
Barney Frank, M.C.

Bernard J Dwyer
Bernard J. Dwyer, M.C.

Chris Smith
Christopher H. Smith, M.C.

Parren J. Mitchell
Parren J. Mitchell

Don Young
Don Young, M.C.

Bill Frenzel
Bill Frenzel, M.C.

Tony Coelho
Tony Coelho, M.C.

Geo C Wortley
George C. Wortley, M.C.

Austin J. Murphy
Austin J. Murphy, M.C.

Dave McCurdy
Dave McCurdy, M.C.

ROCK RAPIDS STATE BANK
301 FIRST AVENUE • P.O. BOX 551 • ROCK RAPIDS, IOWA 51246
PHONE: (712) 472-2537

September 14, 1981

Congressman Berkley Bedell
2440 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Bedell:

Recently you have received letters from several people indicating strong opposition to revenue ruling 81-216, which was issued by the IRS on August 24. As you know, this ruling places more strict limitation on small issue industrial development revenue bonds. This directly affects the Iowa Family Farm Development Authority.

I serve as Vice-Chairman of the IFFDA and would like to add my comments to the ones you have already received.

Perhaps the most distasteful aspect of IRS 81-216, is the fact that it was issued without notice, without public hearing and with immediate effectiveness. I understand that many agencies, including the IFFDA have done considerable work in preparing bond issues for market relying on previously published IRS rulings. For this reason, I would like to see this ruling rescinded. If in fact there are abuses in the issuance of aggregated industrial revenue bonds of one million dollars or less or if the treasury feels that the lost tax revenue because of these types of issues is too severe, it would seem appropriate for treasury to conduct public hearings and announce an effective date which would allow a more orderly change in operating procedures for numerous State Development Authorities.

Here in Iowa, the IFFDA has pursued an individual agricultural development bond program under which industrial revenue bonds as small as $20,000 will be issued to finance the acquisition of agricultural assets for qualifying beginning farmers. This program has some merit but will probably be limited in scope because the funding for these bonds will come from the rural banks making the loans to beginning farmers. However, it is almost certain that the benefits of our program will accrue to the "small" farmer.

Thank you for taking time to consider these comments.

Sincerely,

George

George Schneidermann
President

GS:jm

COUNCIL OF
POLLUTION CONTROL FINANCING AGENCIES

Officers and Directors

President
RONALD BEAN
Executive Director
Illinois Environmental
Facilities Financing
Authority

Vice President
STEVEN BARROUR
Executive Director
Allegheny County
Industrial Development
Authority

Secretary/Treasurer
TOM MCKEWEN
Director
Maryland Environmental
Service

L. JACK DAVIS
General Manager
Gulf Coast Waste
Disposal Authority

JAMES A. DAVIS
Chairman
Missouri State
Environmental
Improvement Authority

ROBERT FITZPATRICK
Executive Director
Wayne County Economic
Development Corporation

CURTIS SOHL
Executive Director
Ohio Air Quality
Development Authority

JESSE UNRUH
Chairman
California Pollution
Control Financing
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H. LAWRENCE FOX
Dawson, Riddell
Fox, Holroyd & Wilson

MURRAY HUTCHINSON
IT Corporation

DORSEY LYNCH
Vice President
First Boston Corporation

J. C. MCKENZIE
Vice President
Salomon Brothers

ROBERT B. MORAN
Corporate Finance Manager
Atlantic Richfield Company

National Office

RON M. LINTON
JAMES B. YOUNG
Executive Directors

September 29, 1981

Rep. Berkley Bedell
Chairman
Subcommittee on Energy and Environment
Committee on Small Business
U.S. House of Representatives
Room B363
Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Bedell:

I am writing on behalf of the state and local agencies who comprise the Council of Pollution Control Financing Agencies in support of your opposition to Revenue Ruling 81-216, issued by the Treasury Department August 24, 1981.

The ability to aggregate small issue bonds is a key to providing sorely needed capital for small businesses who are faced with the cost of meeting environmental mandates. Council member agencies, who work for the increased availability of financing to achieve national environmental goals, have strongly supported the Small Business Administration's Pollution Control Loan Guarantee Program, which has an outstanding record of providing the necessary guarantees for small business pollution control loans.

The Congress recognized this when, with the support of your committee, it increased the ceiling of this program as part of the first budget resolution. It should be noted that due to the modest fees to SBA, and the excellent track record of the program, it constitutes a net addition to the Federal treasury.

The impact of the revenue ruling is to undermine the efforts of the state and local agencies who compromise the Council, and who have in many cases made great efforts to seek out small businesses to inform them of this program, and then to guide them through the complexities of securing the financing they need to comply with pollution control orders.

The Congress, in establishing this program, recognized that aggregating financings into umbrella financings under the SBA guarantee would be a key to its success and provided for that to occur. The Treasury ruling seems to fly in the face of statutory language, but that has not dissuaded the department from its efforts.

I must also comment on the unbending response of the Administration to the appeal of a delegation of governors who met with the President and voiced their concern over the ruling. After being told the ruling would be withdrawn, they later learned that it is being replaced by a proposed regulation, backdated to August 24, so that the freeze will continue

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in effect throughout the period of proposal and comment.

You are well aware of the impact on other financings which this policy threatens. You should additionally be aware that when pollution control mandates are in question, small firms face deadlines which prevent them from waiting for other financing to become available, or for market rates to go down. If these firms cannot manage to structure financings to fit the straightjacket imposed without warning by the revenue ruling, they will face stark decisions on whether to continue facilities, and jobs.

I am enclosing specific examples of how firms have been aided in the attached statement, given before hearings on the program earlier this year in the U.S. Senate Committee on Small Business.

Although the Council will support legislative efforts to overturn the ruling, we feel that what has been done administratively can be undone the same way, far more quickly. Therefore, I want to let you know of our backing for your letter to Secretary Regan, and our availability for any further information and other assistance we can provide.

Sincerely,

Ronald Bean

Ronald Bean
President

Senator D'Amato. Is Governor Snelling here?

[No response.]

Senator D'Amato. We will hold a slot open for the Governor.

Our next witnesses are a panel consisting of Roger Vaughan, deputy director, office of development planning for the State of New York; John Carson, deputy commissioner, department of economic development for the State of Connecticut; Ronald Bean, president of the council of pollution control financing agencies from the State of Illinois; Thomas Williams, commissioner of revenue for the State of Alaska; and Robert Patterson, executive director of the Massachusetts Industrial Finance Agency for the State of Massachusetts.

Gentlemen, each of your prepared statements will be made a part of the hearing record in their entirety at the completion of the oral presentations of the entire panel.

Mr. Vaughan, will you begin?

STATEMENT OF ROGER VAUGHAN, DEPUTY DIRECTOR, OFFICE OF DEVELOPMENT PLANNING, STATE OF NEW YORK

Mr. VAUGHAN. Thank you, Mr. Chairman.

It is a pleasure to appear here on behalf of Gov. Hugh Carey, who in addition to being Governor of New York, is chairman of the Economic Development Committee of the Coalition of Northeastern Governors who have adopted a resolution supporting the limitation of the use of revenue bonds for commercial purposes but strongly endorsing their use for industrial development.

A copy of that will be submitted with written testimony, which I would like entered into the record.

As you are all aware, the question of the use of State and local revenue bonds to finance economic development has come into very close review and strong criticism during the last 12 months. The most obvious manifestation of that is the recent Treasury ruling.

I would like to address that and then address briefly the broader issue of revenue bond financing.

The abuse of industrial revenue bonds to finance retail operations and fast food franchises, and even adult bookstores, has been well documented. Obviously, it requires action. We recognize the need to limit.

However, the Treasury ruling is the most capricious and inappropriate way of limiting revenue bond financing. It will exclude only small businesses and allow larger businesses with larger issues to continue to be issued.

We applaud the efforts of Senators Weicker and yourself with S. 1635 to delay the implementation of this capricious ruling and urge the Senate and the House to overturn this action.

Pooling, which is prevented by the Treasury ruling, allows the fixed cost of issuing bonds to be spread over several issues which reduces the cost to small firms. There will be no impact, as I said, for large commercial projects.

The ruling also penalizes efforts by States to help expand their economic base. We have on this panel representatives of many State agencies which have used these bonds wisely. I would like briefly to speak on behalf of the New York State Job Development Authority.

This authority, which has issued nearly $220 million worth of bonds to 1,200 firms in New York, together employ 90,000 people. Over $600 million worth of investment has been generated by these actions. It has never issued a bond for commercial projects. It is tightly targeting its efforts in our distressed areas.

In November there will be a constitutional amendment before the electorate in New York to increase the bonding capacity from $150 to $300 million. We regard this as a critical effort by New York in its economic recovery.

Let me just address four issues which I think are critically important as we look at the broader issue of whether or not revenue bonds should survive.

First, in its effort to close what the Treasury has called a loophole, we seem to be forgetting that the total amount of revenue bonds issued this year will probably be $8 or $9 billion while there will probably be $160 billion by some estimates of all-savers certificates issued.

These will place the tax-exempt market under a considerable strain at a time when State and local tax-exempt financing is under such strain and at a time when the real rate of interest—the difference between the market rate and the rate of inflation—is now in double digits. It seems highly inappropriate to look at a relatively small program, such as revenue bonds—small in its Treasury impact but massive in its impact in the ability of States to deal with economic development issues.

Second, we do endorse limiting revenue bonds for commercial purposes. Let me suggest one or two ways in which this might be done.

We do believe that States working with Washington can effectively target this program to reduce the revenue loss without reducing the economic development impact.

It would be possible, for example, for Washington to rule that the number of commercial bonds could be limited, perhaps, to say 25 percent of the total revenue bonds issued in the State so that the focus will be on industrial purposes.

The Federal Government must do the limiting, because the competition between States for scarce jobs and scarce investment makes it very difficult for a State to act unilaterally.

The focus, as we limit the bonds, should be on encouraging them for small business. It is, I believe, completely inappropriate that large business, which has ample access to capital, should be using these bonds.

There should also be greater emphasis on distressed areas.

Here I would say that it should be the State government that should identify distressed areas—perhaps with a Federal ruling that distressed areas be identified that encompass no more than 15 percent of the State's population, and any form of revenue bond financing in those areas would be eligible. Outside those areas, only industrial bonds would be used.

The per capita ceiling of the approach which has been proposed in Washington seems to me, again, a totally capricious way of limiting these bonds. It does nothing to help small business; it does nothing to help new business; it does nothing to help distressed areas.

The third point I would like to make is that at a time when there are significant cutbacks in Federal expenditure, particularly on economic development programs—SBA, Farmers Home, the

Economic Development Administration—to remove this tool for State governments at a time when all the other tools are being removed seems cruel and unusual punishment.

We in New York have estimated that the Federal budget cuts will cost us upward of $2 billion. That will necessitate a reduction in our own expenditures in infrastructure. To remove revenue bonds as well seems totally unnecessary.

Finally, we in New York endorse the administration's approach to a New Federalism that will give more power to States, both fiscal and administrative power. This ruling by Treasury and the threat to remove tax exemtions for industrial bonds, strikes me as a very dangerous precedent.

The Federal Government has long recognized that it will not tax State and local public bonds. Suddenly to remove tax exemption for these purposes is a very dangerous precedent.

We will stand ready to work with the President and the administration in reducing public spending. We have an admirable record, I believe, in New York in the last 5 years of cutting spending.

If we are to do that, it must be in an atmosphere of trust and there must not be these sudden and capricious actions taken that jeopardize our own self-help activities.

Thank you.

Senator D'AMATO. Thank you very much.

[The prepared statement of Mr. Vaughan follows:]

PREPARED STATEMENT OF ROGER J. VAUGHAN, OFFICE OF DEVELOPMENT PLANNING, NEW YORK STATE

Mr. Chairman, members of the Subcommittee, it is a pleasure to appear at these important hearings on behalf of Governor Hugh L. Carey. Governor Carey heads the Economic Development Committee of the Coalition of Northeastern Governors (CONEG). The Coalition regards IDBs as a critical element in their program to rebuild the Northeastern economy and views attempts to abolish or undermine the use of revenue bonds as a serious blow to those efforts. At its annual meeting in August 1981, CONEG adopted a resolution supporting the limitation of IDBs for commercial projects but strongly endorsed the retention of the program.

Following the Treasury ruling 81-216 issued in August, Governors Thornburgh and Garrahy, on behalf of CONEG, wrote directly to President Reagan requesting that the ruling be withdrawn. I have attached copies to this testimony.

We are aware of the need to control public spending and to plug tax loopholes, but we do not think that the capricious action by the IRS is an effective way to achieve these goals. Not only will the ruling unfairly and needlessly penalize small businesses--precisely those companies that are denied alternative sources of long term financing--but it also undermines the "new federalism" so recently espoused by the Administration by removing a powerful policy instrument from state and local governments. Indeed, it even poses a threat to the constitutional right of state and local governments to issue tax exempt securities for public purposes.

Treasury Ruling 81-216

The abuse of Industrial Revenue Bonds to finance retail operations, fast food franchises, and even adult book stores has been well-documented in newspaper reports and in a careful report by the Congressional Budget Office. New York and other Northeastern states has recognized that, too often, the right to issue tax exempt bonds has been extended far beyond the original public intent, and has been used to finance projects that were capable of being financed through conventional means. We have called for limitation of IDBs, non-industrial IDBs (see below).

However, the Treasury ruling is completely inappropriate way of limiting the use of IDBs. It will exclude small and new businesses, regardless of their contribution to the local community and their need for finance. We applaud the efforts by Senators Weicker and D'Amato to introduce legislation (S.1635) to delay the implementation of this "cruel and unusual" ruling and urge the Senate, and the House, (where comparable legislation has been proposed by Congressman Tom Downey, H.R. 4507) to reverse this ruling.

Pooling--which is prevented by the Treasury ruling--allows the fixed costs of issuing bonds to be spread over several issues, which reduces the costs to small firms. There will be no impact on reducing issues for commercial projects--the majority of which are private placements--or for large firms. The ruling will eliminate only small firms, which are exactly those companies which could benefit most from IRBs and whose financing will benefit the local community by providing new jobs.

The ruling also penalizes the efforts by states to help expand this economic base. The Pennsylvania Industrial Development Authority, the

Economic Development Authority in New Jersey, the Massachusetts Industrial Finance Authority, the Umbrella Bond program in Connecticut, and the Job Development Authority in New York have all used the tax exempt to help generate jobs. The New York State Job Development Authority, in its 20 years of existence, has made nearly $200 million of loans to 1,200 companies that employ 90,000 New Yorkers. Many of these companies are located in distressed neighborhoods. Their survival--made possible by JDA's assistance--has brought renewed hope and economic opportunity to those by-passed by the economic mainstream. This fall the people of New york will vote on a referendum to extend JDA's bonding capacity from $150 million to $300 million. Governor Carey regards this as a top priority in the State's continuing program for economic recovery. The Treasury ruling will prevent JDA from assisting small and new businesses.

The intent of the IDB programs operated by states and localities is two-fold. First, to assist small and new businesses in acquiring capital on terms comparable to large businesses. Second, to assist companies in distressed areas have access to capital when it is not available from conventional lenders. We have met these goals effectively and prudently. JDA has a loss record comparable to many banks and has never required any direct state support. Few federal development finance programs can boast such a record.

The Economic Climate

The attack on IDBs could not come at a less appropriate time. Real interest rate--the difference between the rate of inflation and the rate charged by banks--has reached the highest level in fifty years. Small businesses, with little access to equity capital, are facing crippling interest costs.

Indeed, not only do small firms face problems in raising capital but states and localities are finding it increasingly difficult to borrow funds. The new "All-Savers" certificates will tighten the tax-exempt market still further. However, abolishing IBDs would provide no relief according to most studies. While about $8 billion of IDBs will probably be issued during the next 12 months, estimates of the volume of "All-Savers" certificates run as high as $150 billion. If the IRS wishes to close costly and ineffective loopholes, IBDs are the last place they should look.

Limiting IDBs

There are effective and equitable ways to reduce the volume of IDBs without jeopardizing their use as an economic development strategy. We support limiting commercial projects eligible for IDB financing to distressed areas. Outside targeted areas, commercial projects do not merit the interest subsidy--a fast food franchise will be built if there is a market for it with or without a subsidy. Congress should take action to eliminate the abuses whose coverage by the press has led to the present hostile climate to industrial revenue bonds.

However, we would not suggest Congressional legislation that would place the responsibility for designation of distressed areas on the Federal Government. State governments know better than federal bureaucrats where assistance is needed and must have the power to identify target areas.

Members of the Administration have indicated that they wish to abolish all IDBs, pollution control bonds and hospital bonds. This would be an irresponsible and harmful step. Targeting can reduce program costs, just as expenditure cuts are being imposed on all federal programs.

The New Federalism

The burden of the new federalism--both administrative and fiscal--is falling heavily on state governments. In the Northeast, with its aging infrastructure and the economy disrupted by growing imports, the reduced federal grants will impose special hardship. New York has learned painfully to live with less. We are prepared to do more to reduce public spending. However, fiscal restraint works most successfully in a growing economy. With cuts in traditional federal economic development programs--EDA, SBA, FmHA--it is singularly inappropriate to limit revenue bonds which remain one of the few policy tools left to states.

If we are to reorganize the allocation of responsibilities among federal state and local governments that allows us to reduce the cost of government in equitable way, then the new federalism must be built on trust. That trust is seriously undermined by capricious bureaucratic rulings that limit the capacities of state governments with no notice and no good reason.

In summary, New York and the Northeastern states stand ready to eliminate abuses from the IDB program and to assume greater responsibility for shaping our economic future. But we urge the Administration and Congress to help us ensure that this process proceeds in the spirit of partnership. We owe it to our own state residents and to the nation as a whole to avoid the type of action that has precipitated these hearings. We hope that the IDB program will be sensibly refined and that Treasury ruling 81-216 will be withdrawn.

APPENDIX

I. CONEG Industrial Development Bonds Resolution

II. CONEG Press Release on IRS Ruling 81-216

III. CONEG letter to President

IV. New York State Congressional Delegation Memorandum

CONEG
COALITION OF NORTHEASTERN GOVERNORS
400 NORTH CAPITOL STREET, N.W.
SUITE 382
WASHINGTON, D.C. 20001
(202) 624-5440

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

INDUSTRIAL DEVELOPMENT BONDS

WHEREAS, the Coalition of Northeastern Governors regards industrial development bonds as an important economic and community development tool to stimulate capital investment and employment. At a time when federal development assistance is being sharply reduced or eliminated, this financing mechanism must remain available to State and local governments as a development incentive for private investment and;

WHEREAS, we also recognize that legitimate concerns have been raised regarding abuse of small issue industrial development bonds, particularly those issued for commercial purposes.

THEREFORE, BE IT RESOLVED that the CONEG Governors recommend the following changes in federal legislation in response to that criticism:

- o Target commercial IDBs to distressed areas by providing broad federal guidelines within which States have the flexibility to determine the targeted areas based on State and local economic objectives.
- o Exempt from these restrictions special economic activities which are of particular importance to a specific State's economy and which encompass less than 5 percent of the States's economic base.
- o Exempt all production activities from research processing to warehouse-distribution from targeting limitations.
- o Establish federal monitoring and annual reporting requirements by States for all small issue IDBs issued in each State.

CONEG CONEG CONEG
COALITION OF NORTHEASTERN GOVERNORS

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

FOR IMMEDIATE RELEASE
Monday, September 14, 1981

CONEG POLICY RESEARCH CENTER
CONTACT: Connie Saulter
(202) 624-5440

GOVERNORS SAY NO TO IRS RULING ON INDUSTRIAL REVENUE BONDS

WASHINGTON, D.C., September 11 -- Pennsylvania Governor Dick Thornburgh, Chairman of the eight-state Coalition of Northeastern Governors (CONEG) and Rhode Island Governor J. Joseph Garrahy, Vice Chairman of CONEG, have called for White House withdrawal of a recent Internal Revenue Service ruling that would eliminate the current tax exemption for state industrial development bond pools used to provide loans to small and medium size businesses. The IRS ruling, issued on August 24, would eliminate the ability of states to package a series of small business loans into a single tax-exempt "umbrella" or pooled bond issue.

In a September 9 letter to President Reagan, Governors Thornburgh and Garrahy said that the effect of the new IRS ruling will "severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates."

Governor Garrahy noted that the Northeastern states "have pioneered the use of pooled bond issues as a way of targeting tax-exempt financing to small businesses that are shut out of the private capital market." Garrahy cited recent studies which show that small businesses create more than 80 percent of all new jobs in the economy each year, a fact which has led many states to focus on the small business sector in their economic development efforts.

Governor Thornburgh called state industrial development bond (IDB) programs "a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast." "We believe this ruling is ill-conceived and represents a dramatic step in the wrong direction", Thornburgh said.

Several Northeastern states have used "umbrella" or "pooled" IDB's to finance loans to small and medium size businesses. Rhode Island this year has also initiated a similar program that has already assisted a number of small Rhode Island manufacturers.

Connecticut has issued umbrella bonds totalling $195 million over the last ten years. The Connecticut program has provided assistance to more than 500 small firms, and is estimated to support the creation of more than 9,000 new jobs annually in that state.

New York's umbrella bond program has provided loans to more than 1,200 companies, with total employment of over 90,000 workers.

(over)

The Pennsylvania Industrial Development Authority (PIDA) has issued IDB's totalling more than $92 million since 1975, the proceeds of which have financed more than 400 loans to firms employing roughly 33,000 workers. Several other Northeastern states have developed plans for issuing pooled IDB's, but have been stopped by the new IRS ruling.

The Governors expressed concern to the President that this ruling hinders possible action by Congress to enact reform legislation governing the issuance of small issue industrial development bonds. In light of this legislation, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legation to "ensure the responsible and targeted use of this economic development tool."

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CONEG
COALITION OF NORTHEASTERN GOVERNORS
400 NORTH CAPITOL STREET, N.W.
SUITE 382
WASHINGTON, D.C. 20001
(202) 624-5440

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

September 9, 1981

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

On behalf of the Coalition of Northeastern Governors, we wish to register serious concern regarding the effects of Internal Revenue Service Revenue Ruling 81-216 on state industrial development bond (IDB) programs. This ruling, which was issued without prior consultation, eliminates the current tax exemption for multiple lots of small issue revenue bonds of less than $1,000,000 used to provide loans for small and medium size businesses. We believe this revenue ruling is ill-conceived and represents a dramatic step in the wrong direction for IDBs.

The Northeastern states have pioneered the use of so called "umbrella" or pooled bond issues as a way of targeting tax-exempt financing to smaller firms that face particular difficulties obtaining needed capital in the private market. We view the targeted use of this financing technique as a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast. The effect of this IRS ruling is to severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates.

Congress is currently considering legislative changes to establish more stringent guidelines for state and local IDB programs. In addition, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legislation to ensure the responsible and targeted use of this economic development tool. A copy of this resolution is enclosed for your review. We believe it is a serious mistake for IRS to preempt the legislative process by suddenly reversing longstanding precedents and rulings in this area, and we strongly urge that this ruling be withdrawn.

Thank you for your consideration of this matter.

Sincerely,

Governor Dick Thornburgh
Chairman
Coalition of Northeastern Governors

J Joseph Garrahy

Governor J. Joseph Garrahy
Vice Chairman
Coalition of Northeastern Governors

DT/lw

cc: Secretary Donald T. Regan
  U.S. Department of Treasury
 John E. Chapoton, Assistant Secretary
  U.S. Department of Treasury
 Dan Rostenkowski, Chairman
  U.S. House of Representatives, Ways and Means Committee
 Barber Conable, Ranking Minority Member
  U.S. House of Representatives, Ways and Means Committee
 Robert Dole, Chairman
  U.S. Senate Finance Committee
 Russell Long, Ranking Minority Member
  U.S. Senate Finance Committee
 Northeast Congressional Delegation

Memorandum

STATE OF NEW YORK
WASHINGTON OFFICE

September 22, 1981

TO: New York State Congressional Delegation

FROM: Brad C. Johnson

RE: IRS Ruling 81-216

IRS Ruling 81-216, issued August 24, 1981, will have a drastic negative impact on small business development throughout New York State. The ruling, which was issued without prior consultation, revokes tax exempt status for multiple lots of small issue industrial revenue bonds (IRB's) used to provide loans to small and medium businessss.

New York State is supportive of legislation which responsibly curtails misuse of IRB's. This ruling, however, penalizes the honest business along with the abuser. The ruling does not delineate between commercial and industrial bond use and represents a dramatic step in the wrong direction for IRB's.

New York's Job Development Authority (JDA) has long been a source of capitol assistance to New York's small manufacturers. This ruling will force the authority to cease marketing IRB's thus drying up an essential source of inexpensive capitol for the state's small business community. JDA assistance has been used to retain and develop employment opportunities and promote business retention and expansion. During the past 2 years JDA supplied $50 million to 250 New York firms.

Senator Weicker has introduced S. 1635 which would delay implementation of this ruling. Congressman Downey has introduced similar legislation in the House, H.R. 4507. I strongly urge you to support these measures.

For more information please call Paul Schieber in this office.

Thank you for your time and support.

BCJ:cam

Senator D'Amato. Mr. Carson?

STATEMENT OF JOHN J. CARSON, DEPUTY COMMISSIONER, DEPARTMENT OF ECONOMIC DEVELOPMENT, STATE OF CONNECTICUT

Mr. Carson. Thank you, Mr. Chairman.

I am appearing here today on behalf of Governor O'Neill and Commissioner Edward Stockton, who also serves as the chairman of our Connecticut Development Authority, a tax-exempt industrial revenue bond authority for the State of Connecticut.

We are here in full support of delaying the implementation of IRS Revenue Ruling 81-216. If we had our druthers, we feel strongly that the best course of action, of course, would be to revoke that ruling altogether. That would be the most logical action, since that ruling really cuts into the very heart of what we believe in Connecticut is the most justifiable of all revenue bond activities.

However, we also are realistic and appreciate the concern in the Congress over the scattered abuses in revenue bonds that have been reported. We concur that delaying the ruling until all the evidence is in concerning revenue bonds may be the best way to proceed at this time.

What troubles us most, I think, in the State of Connecticut, which has had a long history of using tax-exempt financing, and particularly the revenue umbrella bond program, is that the IRS has, by executive fiat, eliminated what we believe is the best of all revenue bond programs and truly one program that aids small viable businesses.

In effect, by that ruling, the abuses which have been heard and discussed by the Congress over the past few months, in terms of tax-exempt financing, have been left untouched, while small- and medium-size companies who need this economic encouragement the most are being penalized.

We do agree that in some cases revenue bonds have gotten out of hand. Yet we must stress that we believe States, such as Connecticut and some of the other States you will be hearing from today, have utilized revenue bonds responsibly and effectively and should not be penalized for the excesses of others.

We are prepared to support selective restrictions in industrial revenue bond activity, because we do realize the need to control Federal expenditures and to maximize potential revenue.

Still we are unwilling to support actions which will in effect, as others have said, throw the baby out with the bath water.

We believe that the time has come for the Nation to really get serious about the intense worldwide competition that our companies face. We must have a rational and consistent national economic policy aimed at improving the competitive position of U.S. manufacturers in order to preserve and create the many millions of jobs that are going to be needed and are being forecast for the 1980's.

We also very strongly believe that economic policy must not be shaped in back rooms, free of reasonable debate and devoid of what I feel very strongly is a lack of economic understanding.

Congress, we feel, must be the vehicle to package together all of the economic pieces in order to give shape to a consistent national policy.

Accelerated depreciation and investment tax credits are certainly half of the equation needed to improve productivity here in this country.

The new national thrust that has come out of the tax act can be totally neutralized in many respects by the revocation or unreasonable curtailment of tax-exempt industrial revenue bonds.

Industrial revenue bonding has been an important tool in our own State of Connecticut. It has made the difference in many cases for manufacturers faced with a decision to close or rebuild old plants—for a State that was on the forefront of the industrial revolution over 200 years ago.

I am certain that this same kind of decisionmaking has been faced by companies in other States, particularly in the Northeast.

We are facing enormous competition from overseas companies, and we think that curtailments on industrial revenue bond programs would put American business at a substantial competitive disadvantage.

We would favor limiting the use of industrial revenue bonds to projects which are economically justifiable. This, in our estimation, includes the multiple issue bonds, such as the umbrella bonds, packaged in a way that small- and medium-size manufacturers have the same access to tax-exempt financing as the large corporations, such as United States Steel, General Motors, and others.

Nonrecognition in the bond market and the exorbitant cost of underwriting a bond issue would make it prohibitive for the small- and medium-sized manufacturing company to use revenue bonds on a conventional basis.

I think I can assure you with some degree of certainty based on my experiences that the majority of the small manufacturers we have worked with in Connecticut, using revenue bonds, would be unable to undertake these projects if they had to go the conventional lending markets to receive funds at interest rates of nearly double what they would receive through revenue bonds.

For that matter, many of these companies would not be able to obtain the loans, no matter what interest rate might be charged.

That is what is so incredible from our point of view about the recent IRS ruling 81-216 because it eliminates the very revenue bond activity that all of us speak so highly about—that is small and medium business are the backbone of our U.S. economy.

We in Connecticut, as our other fellow States, say that small business is the backbone. We believe, and have believed with our program, that we have put our money where our mouth is.

The State of Connecticut does stand behind its umbrella bonds. In the last session of the general assembly it increased the authorization from $200 to $300 million. It got full legislative debate at the State level.

We also support industrial revenue bonds for manufacturing and related production facilities because of the importance of these activities to the much touted reindustrialization process in this Nation.

We also believe and support the fact that revenue bonds should be available to selected commercial and retail projects in distressed urban communities. These are definitely areas which are sorely in need of development, as well as the extra incentive to attract that development.

It is one of the few ways we believe that we can stimulate the creation of new job opportunities for our minority populations which continue still to be far outside the economic mainstream.

We are proud of our industrial revenue bond program in Connecticut, and we make sure that a public purpose is the guide to our program. We insert a public purpose call in all bond issues that requires the facility be utilized for an eligible purpose for the life of the bond.

A violation of that provision would result in the withdrawal of the tax-exempt status of the bond.

We are not insensitive to the needs of the Federal Government to cut its costs and tighten up losses in revenues. We believe very strongly that it would be counterproductive to the current national drive to economic development in the heightened competitive worldwide competition to put into place new and innovative economic incentives and at the same time to revoke the economic stimulants, such as revenue bonds.

I thank you for your time.

I will be submitting into the record not only my statement but a more detailed statement of the Connecticut Development Authority, a technical statement specifically on 81-216, and some correspondence our State has had with the tax department.

We do thank you particularly for this opportunity to appear.

Senator D'AMATO. Thank you.

Senator Dixon?

Senator DIXON. Thank you, Mr. Chairman.

It is my pleasure this morning to introduce to you a man who I introduced on May 7 to this committee. He is a man who I believe brings considerable expertise to this committee room.

Mr. Ronald Bean is the president of the village of Park Forest which is located in the major county in my State, Cook County, Ill.

He is also executive director of the Illinois Environmental Facilities Financing Authority. The authority currently has $703 million in bonds outstanding, $24 million of which is for small business.

Mr. Bean also serves as president of the National Council of Pollution Control Financing Agencies. He is a former vice president of the American National Bank of Chicago where he specialized in corporate trust, bond indenture, real estate trust, and corporate escrow.

He is a former real estate analyst for the Shell Oil Co. and a board member of the Gavin Foundation, a philanthropic organization based in Park Forest.

Mr. Bean is a graduate of Roosevelt University in Chicago and of DePaul University School of Law.

Mr. Chairman, it is my privilege to introduce to you Mr. Ronald Bean from the State of Illinois.

Senator D'AMATO. Mr. Bean?

STATEMENT OF RONALD BEAN, PRESIDENT, COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES, AND EXECUTIVE DIRECTOR, ILLINOIS ENVIRONMENTAL FACILITIES FINANCING AUTHORITY, STATE OF ILLINOIS

Mr. **Bean**. Thank you, Mr. Chairman, and Senator Dixon.

I am Ronald Bean, executive director of the Illinois Environmental Facilities Financing Authority, and president of the Council of Pollution Control Financing Agencies.

The council is composed of State and local public agencies who serve as issuers of pollution control financing. The member agencies of the council accounted for over 30 percent of the recorded pollution control financings for 1980.

As public officials, many of us are institutionally linked with our State and local economic development efforts. Our purpose is to foster the availability of capital for industry to meet the ambitious environmental goals set forth in national laws. For me and many of my counterparts across the country, this has special importance for the small businesses in our jurisdiction.

I will leave to others the details of how small business simply does not have equal access to capital and how the industrial development bond financing has been able to help them gain some parity.

I want to emphasize that this applies with double force to small businesses ordered to meet pollution control mandates. For a business which has limited or no access to capital markets, an order to install an expensive, nonproductive facility is a death sentence.

Fortunately, the existence of the Small Business Administration's pollution control loan guarantee program and the ability to aggregate issues into financings of a marketable size have been able to overcome this burden for many small businesses. The result has been that jobs have been preserved or created while environmental goals have been attained.

Much has been said of benefits which will flow to industry from recently enacted tax legislation. However, close examination will show that less than a proportional share of such benefits will go to the small businesses caught in the national economic turmoil, even though it is just these companies that will generate the jobs and economic activity, which will make the difference in a national turn-around.

A case in point is the Treasury's recent ruling, now to become a regulatory proposal, which in effect cancels much of our ability to combine small financings. It serves no purpose, environmentally or economically. It was done suddenly, posing a serious threat to current plans of many businesses, and has been left in effect pending final regulatory action.

The ability to aggregate issues is crucial to the success of the SBA program which this committee has strongly supported. The council has applauded your action to increase the ceiling on the program to $250 million per year.

In testimony on that issue, I presented the committee with numerous case histories from council members. A copy of the testimony accompanies this statement. I will not repeat them, but I would like to illustrate one case for the committee's benefit.

Del Mar Plating in Franklin Park, Ill., has 18 employees. It needed $180,000 for equipment to meet air and water pollution control requirements.

Fred DeMaria, the company's president, said he was able to find commercial bank loans available only at 23 percent with a maximum 7-year payback. He said: "While the price alone made the heart flutter, the interest rates were ample incentive for cardiac arrest."

Remember that this is for equipment which is not going to produce any income for the company.

We were able to arrange a financing of the $180,000 by combining it with a financing of $2.4 million for another company and going to the market with a combined issue of $2.580 million.

Mr. DeMaria says:

> I really could not pay the commercial bank rates; they are devastating. I do not think the business could have continued to make it.

All in all, the Illinois Environmental Facilities Financing Authority has issued $21 million in bonds for financings for 29 companies, with a total of 2,092 employees. The jobs are still there; the environmental mandates are being met; the funds are being repaid without a single default.

As I pointed out in my previous testimony, the Federal Treasury has realized a net gain through operation of this program. None of this would have been possible under the suspension of the ability to combine loans which is now in force.

I would like to also point out that the inability of these companies to get capital does not prevent the major companies in the United States from having access to the capital markets through taxes and financing.

One of the key elements of the small business financing program that has been presented to this committee and is uppermost in the minds of we in Illinois is that small businesses should have equal access with the major companies.

Finally, I would like to touch on a larger issue—the continued opposition of the Treasury to tax-exempt financing.

The council is deeply suspicious of the tax expenditure estimates produced by opponents of such financing. The Congressional Budget Office, while perpetuating such estimates in its own report on the subject, stopped short of promising that eliminating IDB financing will therefore mean a corresponding increase in revenues.

I can guarantee, however, that if such financings are eliminated by legislation or by unilateral administrative actions, small business will be denied equal access to capital in a period when that means the difference between success and failure for our Nation's economy and the local economies of many of our communities.

The council shares the concern of this committee and offers whatever support we can provide for your continuing oversight.

Thank you.

Senator D'AMATO. Thank you.

Mr. Williams?

STATEMENT OF THOMAS K. WILLIAMS, COMMISSIONER OF REVENUE, STATE OF ALASKA, AND VICE CHAIRMAN, ALASKA INDUSTRIAL DEVELOPMENT AUTHORITY

Mr. **Williams**. Thank you, Mr. Chairman.

My name is Tom Williams. I am the commissioner of revenue of the State of Alaska. I am here as the Vice-Chairman of the Alaska Industrial Development Authority—[AIDA].

It is interesting to be here. We have representatives from the States of New York, Illinois, Connecticut, and Massachusetts. On a number of issues, Alaska and these States do not see eye to eye.

I think it is illustrative of the national impact of industrial revenue bonds and the benefits that they produce—not just in one region but across the Nation—that I am here with the same view about the importance of continuing this program as the other representatives.

My primary purpose here in testifying is to explain briefly how AIDA works, what it means for Alaska's future, and why restricting or ending the availability of IDB's would hamper and frustrate our program.

AIDA is an instrumentality of the State and serves statewide constituency. It is a source of capital for economic development through issuing IDB's.

Under the Internal Revenue Code, there are three categories of developmental projects that qualify for this type of financing: Certain tax-exempt facilities, such as docks and pollution control equipment, which qualify regardless of how much they cost; certain projects in which there is a capital limitation of $10 million—not more than $10 million can be invested in a political subdivision, either 3 years back or 3 years after the date of the issuance; and, finally, the small issue exemption of $1 million or less.

Until this year, AIDA only issued bonds on a stand-alone basis for larger projects which either qualified as tax-exempt facilities or else met the $10 million capital limitation.

However, last year the Alaska Legislature amended AIDA's powers to allow the combined issuance of separate series of bonds for small projects of $1 million or less in order to extend to small businessmen the opportunity to obtain tax-exempt financing which larger businesses were enjoying.

Because of the practical impossibility of getting a bond rating for each small business and winning market acceptance of bonds for each small business on a project-by-project basis, these bonds are issued instead under the umbrella of a pledge of AIDA's own general obligation and assets which are quite considerable as well as a pledge of the moral obligation of the State of Alaska.

This pledge provides a common source of security for AIDA's umbrella bonds in addition to the security provided by the project owners. As a practical matter, it has been chiefly on the strength of AIDA's pledge that these bonds have been rated and accepted in the marketplace.

This past June, AIDA had its first sale of umbrella bonds, totaling more than $17 million for 50 different projects. A few were for the full $1 million maximum amount, but you can tell from the average of only $340,000 per project that most had to be for considerably less. We had one that was for $20,000.

We have an application pending now that was grandfathered by the IRS for $15,000.

Clearly, this is not a tycoon who is enjoying the benefits.

The types of projects that we finance range from commercial fishing vessels for Alaska's newly developing bottomfish industry to computers, construction equipment, and warehousing.

Some of these projects might have been able to afford conventional financing at today's sky-high interest rates but many others could not. For them, the AIDA umbrella program made the critical difference.

The importance to Alaska of allowing AIDA to continue to make this difference must not be underestimated. Right now, Alaska and her people are enjoying a period of moderate prosperity thanks to a freak of geology known as the Prudhoe Bay oilfield.

Senator **D'Amato**. I wish it were in my State.

Mr. **Williams**. I wish we had one in all 50 States; then we would not have to worry about OPEC.

One percent of this enormous resource is depleted and forever gone every 60 days. Hence, it is absolutely imperative for Alaska's future well-being that we diversify our economy into other, more sustainable activities while we can. AIDA's role in facilitating that diversification is obvious.

Recently, industrial development bonds have come under attack. Critics assert that there are too many McDonald's and K-Mart stores being financed with tax-exempt bonds. Some point to certain political subdivisions that are issuing bonds for projects outside their jurisdictional boundaries, apparently with the sole objective of getting a fee for issuing them.

In reaction to these and other criticisms, the IRS issued Revenue Ruling 81-216. We see legislation pending before Congress or being discussed on both sides of the issue.

Before commenting on IDB's generally, let me briefly address Revenue Ruling 81-216. In my opinin, this is the worst idea of the IRS in a long time.

The ruling does not end industrial development bonds for McDonald's or K-Mart, or for that matter for anyone else. However, it makes it easier for McDonald's and K-Mart to get them than it does for the small businessman.

The ruling does not actually put an end to the ability to combine issues like AIDA's umbrella program.

What it does is, it cripples the ability of these authorities to do so by limiting them to $10 million.

The maximum of combined projects that would be issued under an umbrella program must satisfy together, for all the project applicants, the $10-million limitation on capital investment.

In most cases, this is to make it either too expensive or impractical for many of our businessmen.

The reason that it makes it too expensive is that when you have this smaller size of combined issue with a relatively fixed cost of issuance, then the rating agency fees, printing fees, attorney fees, and so on, all become proportionately greater in relation to each project. Thus, the benefits of getting tax-exempt and financing are offset by the extra costs of getting that financing.

This works OK when you are a giant firm, because the giant firms can either absorb the cost without unduly affecting their profit and loss statement, or—and this is what is more likely—they can pass the cost right on to the consumer because they have a big volume of sales. They can offset these costs with a tiny fractional increase in their prices. The cost is borne by the public, and it gets passed on to them.

The small businessman does not have either luxury. For him, this is probably his only business. It is all or nothing for him. His constituency and his clientele and his customers are from a local area. He cannot afford to raise his prices so as to offset $50,000 or $100,000 of issuance costs.

Thus, the ruling works exactly backward from what it presumably was intended to do.

To return to the subject of IDB's in general, I acknowledge that some abuses have developed that should be corrected, particularly regarding local bonding for projects outside the locality's jurisdiction and perhaps also for financing go-go joints or other questionable purposes.

However, I do not believe that these abuses justify that IDB's be stopped altogether. Nor do I believe that Congress should limit at this time the purposes to which they may be applied.

Today's high interest rates severely impede business growth and development in America. These rates result largely from Federal overspending and Federal monetary policies.

Wisely, at last, the Federal Government is returning responsibility back to the States in many areas.

As it does so, it must afford the States full freedom to cope with these regained responsibilities, including among the range of abilities to cope, the further development of business which will, after all, bear the burden of the States' expanded roles.

Thus, it would be particularly inappropriate now, in an era of New Federalism, to restrict or take away from the States so valuable a tool as industrial development bonds.

I know it would be very grave for Alaska, and I submit it would ill-serve the Nation as a whole.

Thank you very much for the opportunity to appear here.

Senator D'AMATO. Thank you, Mr. Williams.

Mr. Patterson?

STATEMENT OF ROBERT E. PATTERSON, EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY, STATE OF MASSACHUSETTS

Mr. PATTERSON. Thank you, Mr. Chairman.

I am Robert Patterson, executive director of the Massachusetts Industrial Finance Agency.

It is a pleasure to be here today to put forward what I think are some of the good things about industrial revenue bonds at a time when we have to admit that we are in an aura of abuse. There is a lot of bad publicity around about IRB's. It is a pleasure to sit with a panel and hear in public some of the good things that IRB's have done for the public.

I have longer testimony which I would like to submit to the record, and I would like to summarize it briefly because you have a busy agenda.

It seems to me that Revenue Ruling 81-216 really is only the first shot in this year's attack by the Treasury on tax-exempt financing in general. They have picked on IRB's this time. Last year it was mortgage bonds.

This is a long history of opposition to the tax-exempt feature, which as I understand it dates back from the Constitution and not from the largess of the Federal taxing authorities.

That long opposition has gone back as far as the graduated income tax which first made the exemption really valuable.

There is an aura of abuse, and there are some real abuses. A few of the abuses have been sensationally publicized.

Before the baby goes out with the bath water, at a time of 20-percent interest rates, I would like to take this opportunity to examine some facts.

First of all, facts from the Congressional Budget Office's report:

The CBO concluded and showed that this is primarily a small business program. I would point out that they found that in the last 2 years over 90 percent of the bonds went for the benefit of companies that were not listed on any regional or national stock exchange.

As far as I am concerned, trying to get financing to these kinds of companies, that is the critical test to meet. These are companies that are dependent on local financing institutions.

A second important fact that came out of the CBO report is that this is a program that does create employment and does create tax revenues—Federal, State, and local.

Senator Stevens, I was glad to see pointed out what the true numbers are at page 45 in the CBO report.

I would only add that my recollection was that the Assistant Secretary of the Treasury, Mr. Chapeton, concurred in those revenue estimates at the time of the hearing before the House Oversight Committee back in April.

I would point out that the $700-million figure is all that the Federal Treasury would recoup if they eliminated all industrial revenue bonds, and that would not occur until 1986. In 1982, the number is actually $200 million.

Smaller costs have been shown in a study done at the University of Chicago's Business School which is available from the Small Business Foundation of America.

Speaking from local experience, from a State which was a depressed State until very recently, with an unemployment rate that peaked at 12 percent in 1975, I can tell you that IRB's have been a program of small business and a program to bring back our distressed areas, of which we have all too many.

First of all, on small business: One-half of the companies that we have helped have sales under $5 million. They have to be small businesses by anybody's definition.

Almost three-quarters of them had sales under $20 million.

Let us look a bit closer at these companies. We averaged all the companies in 1980 with sales under $5 million, and I want to share with you what we found.

We found that they were borrowing on the average $665,000 through industrial revenue bonds for new productive equipment. That is key. These are not usable for working capital; this is for new physical assets.

This is at a time when these companies had on average a net worth of only $500,000, sales on average of $2 million, and net income of only $120,000.

Let me point out to you that they were borrowing five and one-half times their net income at one and one-third times their net worth—all at a time of great business uncertainty and the highest interest rates in our history.

You have to remember that the small companies tend to be less well-capitalized and, therefore, they are carrying a lot of other debt also which does not show up in those figures at prime plus one or two.

For another view, we sent out a survey of all the companies we had helped in Massachusetts in the last 2½ years. I would like to share those results with you which are currently being collated and will be certified by Coopers & Lybrand.

Almost a third of the companies responded. We did not threaten them. We told them in the letter that they could have another bond as long as the Federal Government let them—and they were adding assets and employment in Massachusetts—whether they responded or not.

I think everyone will agree that a one-third response rate is phenomenal for a strictly voluntary survey from a Government agency that arrives on the desk of people who have too much to do in their own business.

Of those people who responded, 93 percent said that the IRB affected their expansion plans. One-third said that they would not have expanded without the incentive. One-third said they would have delayed their expansion. One-fifth said they would have expanded less.

That does not add up to 93 percent, because the rest of them said they would have gone somewhere else and not stayed in Massachusetts.

We think that these figures prove that at least at a time of high interest rates, IRB's are an essential incentive for small business. They are also a very powerful incentive, given the other Federal cutbacks that are taking place and probably are likely to continue and maybe even get worse. They are the most powerful development incentive that is likely to be around for the foreseeable future for distressed areas if they will just be used that way by State governments.

In Massachusetts alone, when I joined State government 5 years ago, I was told—in a depressed State like that with all these old cities and all these old mill buildings which were the birthplace of the industrial revolution and now have been bypassed by the changes in our economy—everyone told us to forget it—forget the cities, the downtowns, and the mill buildings and just let them fall down.

In the 2½ years that we have had a program of targeting industrial revenue bonds for commercial activities, as long as they are located in these distressed areas, we have stimulated approximately $150 million worth of investments in these older locations.

That, to me, is quite incredible.

In closing, I think it is important that everyone understand what the true effect in reality of 81-216 will be. Under the guise of tax code technicalities, the Treasury is forcing an incredible change in the financial markets, at least for small businesses.

If I may quote from the recent letter of Governor King of Massachusetts to the President, it says:

"This ruling effectively closes off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible.

"It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral—insurance or bank letters of credit. It is bad enough that these companies must pay higher rates to purchase the collateral they need in order to buy access to the national credit markets. It is unacceptable, however, that the IRS with Revenue Ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased."

Under the guise of tax code technicalities, the Treasury is forcing small businesses out of IRB's.

The reality of this ruling will be to tell smaller companies that they cannot get financing from the national credit markets. Given today's commercial bank prime rates and the condition of the thrift industry which has approximately one-half of the banking assets in the State of Massachusetts, this is tantamount to telling these companies that they can finance their real estate expansions only as tenants of big developers.

Being a tenant in a big industrial park is not what most of the small businessmen I have worked with want as part of their business plans for growing, adding jobs, and investing in the future.

In that regard, I just happened to come across an article in the Boston Globe yesterday when I was thinking what might interest you today. There was a quote from the chairman of the American Stock Exchange who had come to town to talk about small business and the exchange and the future.

He is quoted as saying: "The difficulty of raising capital could become intense in 1982," admitted Arthur Levitt, Jr., chairman of the AMEX. "Traditionally, lenders have looked to the largest companies first in terms of allocation of resources."

This is not, I would submit, a very good time for the Treasury to be tinkering around arbitrarily through rulings with a program which has proven itself as being supportive of small business.

Finally, I would like to quote from the end of the summary of the Congressional Budget Office's report which I would agree with. I agree with Senator Stevens that the CBO did an excellent report on the subject, although it has not been perhaps as accurately reported as it might have been.

"If the Congress eliminated tax-exemption on small issue IRB's, some investments might not move forward. Others might move ahead but changes in the amount and timing of the investment would result. Smaller firms would be the ones most affected.

"Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing."

I could not agree more with this prognosis based on my experience over the past few years in Massachusetts. Abolishing IRB's will save little or no tax revenue and will not be significant in balancing the Federal budget in 1986 or any other year. I urge you to restrict the program responsibly to resist overall restrictions and in the process to legislatively repeal Revenue Ruling 81-216.

Thank you.

Senator D'AMATO. Thank you.

It has been said that the tax-exempt industrial bonds create higher borrowing costs for local governments.

What, if any, has been your experience to date both on the local and State levels? In conjunction with this, have you seen or do you know of any facts that demonstrate that this is the case?

This question is for anyone on the panel.

Mr. Williams?

Mr. WILLIAMS. Mr. Chairman, we have not noticed any difficulty in Alaska's being able to place its own general obligation bonds or our municipalities' being able to do so. We only have a few communities out there which are large enough to have ratings of their own. Others issue bonds through the Alaska municipal bond bank, which is an instrumentality created to issue bonds and be a known issuer in the marketplace. It, in turn, buys the general obligation bonds of the smaller communities.

In all cases, the system seems to be working very well. The problem with interest rates which we are going to see now is going to be from other sources of tax-exempt interest for the investing public.

The all-savers certificate is going to have a far larger impact on interest rates than the continuation of the industrial development bonds.

It is important to note that certificate, being pegged as it is tc a taxable interest rate—namely, the yield on the Treasury auction—is going to close the gap between tax exempt and taxable interest rates.

Senator D'AMATO. For the record, Mr. Williams, although there are many people who hail the new certificate that is supposed to be attracting so much new money, I believe it will to create a far greater loss to the Treasury than what was initially anticipated. One of the reasons I voted against the all-savers certificate is my concern that indeed there would be a dramatic increase in the cost of borrowing money by local municipalities and State governments.

Indeed, many of the financial officers contacted me in regard to this. It seems there was very little thought given to the impact this would have by drying up available revenue pools for local school districts, State bond issues, and local community bond issues. The effect should be felt rather quickly in terms of driving up the cost of money for municipalities.

I concur with your statement, and I think it is tragic that we have pushed this through as an instrument to create housing, and so forth, for all of the reasons that the proponents of it put forth. In all probability very little good will come out of it.

You do not finance long-term needs with a short-term instrument.

Municipalities are going to be hurt, and the consumer in the long run is not going to get the housing that he desires.

Excuse me for interrupting.

Mr. **WILLIAMS**. I had essentially completed my statement, sir.

Mr. **CARSON**. May I just add to that, Senator?

From the point of view of Connecticut and, I think, the commissioner of economic development who serves as chairman of our development authority, we are a statewide industrial revenue bond authority. It is not allowed at the local level in presentations to the bond rating agencies.

In three presentations in my 6 years in office, this question has never been raised and this issue has never been made.

Second, in the last session of the Connecticut general assembly, local government wanted the ability to issue tax-exempt industrial revenue bonds supported by the Connecticut Conference of Municipalities. If it were detrimental to their other tax-exempt financing, I do not think they would have gone to the general assembly to get that power.

Senator D'**AMATO**. All of you, in your capacities for your various States, have not had any occasion where the investment bankers or your financial consultants on the State level have indicated that they have observed that interest costs for your other municipal borrowing has been adversely affected as a result of industrial revenue bonds?

Mr. **PATTERSON**. I would not maintain that the supply does not affect the price.

To the extent that one increases the supply of tax-exempt opportunities, one probably affects the price.

The consultant that the Small Business Foundation of America and ourselves acquired from the University of Chicago did attempt to estimate that effect. He said that no one had estimated it accurately that he could find from an academic point of view, and there is obviously some effect.

I would point out that it is dwarfed by the all-savers certificates. Also, at the time that the Congressional Budget Office study came out, which was last April, which was not very long ago, the study noted that historically the difference between taxable and tax-exempt interest rates has been around 30 percent and that it had grown to 40 percent over the very time period the COB report was reporting a large increase in the volume of tax-exempt IRB's.

That has changed since then, but it cannot have been due to the increase in IRB's.

Finally, what we find from the local officials that we work with is that they are very pleased to have new investment in their communities, because they can tax the new investment. Someone has to pay for this after all.

In Massachusetts, we are heavily dependent on the property tax. This does produce local property tax revenues.

Senator D'**AMATO**. Senator Dixon?

Senator **DIXON**. Mr. Chairman, I would like to ask Mr. Bean whether in his opinion the private financial institutions would provide financing to small businesses for pollution control equipment or economic development, absent the availability of the IRB, or some similar program?

Mr. **Bean**. Most would not. They are not in the market for long-term financing, which is what the businesses need. They need the 10- to 20-year financing. Banks are interested, if at all, anywhere from the 4- to 7-year range.

It would not be available.

Senator **Dixon**. Thank you.

Senator **D'Amato**. Each of you has testified very eloquently and dramatically as to the beneficial impacts industrial revenue bonds have had. I believe you have each indicated that were they not to be there, the kinds of investment, particularly by the smaller entrepreneur in the depressed area, would not take place—certainly not in terms of the kinds of movement and activity that we see there.

Let me ask you this:

What are the kinds of projects that you see imperiled—the kind of economic activity—if 81-216 is allowed to be fully implemented?

Mr. **Carson**. If we look at Connecticut, for example, there are such well-known companies which would not have gone last year as WMZ Manufacturing in East Hartford, Conn., a minority firm.

There are companies throughout our big cities in the State of Connecticut with loans ranging from $850,000 or less, with the average of about $375,000.

Where you are talking about creating new jobs of 15 or 20 at a clip, I would think that if 81-216 continues in place that the volume of activity, although we could come up with a successor program for small business, we would probably be looking at serving only something on the order of one-third or less of the market for small business than we did before.

As I said a moment ago, in Connecticut, those bonds under 81-216 which are affected are for manufacturing-related projects. They are not for commercial projects.

We are a State where 33 percent of our work force is in manufacturing. I think it would be a devastating blow to us.

Senator **D'Amato**. What about the significance to the local tax base?

Mr. Patterson has indicated that one of the beneficial aspects of IDB's, in addition to employment opportunities being increased, has been an expansion of the local tax base that local governments are in such dire need of—particularly, again, in the older communities where there has been an erosion of that base.

Mr. **Patterson**. Again, in the older distressed areas where there has been such tremendous erosion, as you point out, Senator, this program is going to come to a halt, particularly for the smaller projects.

Combined with the chilling effect of the restrictions that are probably going to come out of the Treasury, it will effectively, I think, stop most of that development.

I can think of a number of calls we have been getting from people who are looking at urban areas and doing major big projects in the older cities right now who are calling. Frankly, they are keeping the lawyers up all night now because they are racing to try and beat what they fear will be a retroactive or a very stiff transitional rule, if any rule at all, because of the Treasury's stated hostility.

It is not good. A lot of this investment will come to a stop. If we had interest rates of 6 and 7 percent, I think my agency could just wither away.

I would suggest that maybe we should wait until that happens before cutting off something that has been so dramatic.

We did a study last year which is not yet finished. We think that something like 45 percent of all the square feet added in the State over the last year was assisted through this program.

I think if we can cut it down to small businesses, the percentage will be much larger.

Senator D'Amato. Let me thank all of the panel members for being here today and taking their time to express their concerns.

Let me do something that is probably a bit unusual.

Inasmuch as it is the intention of this committee—and I think I speak with the support of Senator Dixon and Senator Weicker—to move do what we can to eliminate Revenue Rule 81-216, I would ask you that, if you feel as strongly as we do, that you speak to your congressional delegations, both in the Senate and the House, so that hopefully we can muster the kind of support necessary to reestablish the fact that there are three branches of Government, one being the legislative branch. The executive branch, under Treasury, is not all-powerful and not all-knowing.

In this battle, we call upon you to bring this message to your State delegations—join with us in this effort to establish the balanced constitutional form of government that I thought I would be participating in when I came to this august body, the U.S. Senate.

Thank you all very much.

[The prepared statements of Mr. Carson, Mr. Bean, Mr. Williams, and Mr. Patterson follow:]

TESTIMONY OF EDWARD J. STOCKTON, CONNECTICUT COMMISSIONER OF ECONOMIC DEVELOPMENT AND CHAIRMAN OF THE CONNECTICUT DEVELOPMENT AUTHORITY, REGARDING REVENUE RULING 81-216 AND PROPOSALS TO RESTRICT SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS

RESPECTFULLY SUBMITTED TO THE
URBAN AND RURAL ECONOMIC DEVELOPMENT SUBCOMMITTEE
OF THE SENATE COMMITTEE ON SMALL BUSINESS

AT HEARINGS HELD ON
OCTOBER 5, 1981

Presented on behalf of Commissioner Stockton
By John J. Carson, Deputy Commissioner

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CONNECTICUT COMMISSIONER OF ECONOMIC DEVELOPMENT AND CHAIRMAN OF THE CONNECTICUT DEVELOPMENT AUTHORITY, REGARDING REVENUE RULING 81-216 AND PROPOSALS TO RESTRICT SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS

EXHIBIT A	POSITION OF THE CONNECTICUT DEVELOPMENT AUTHORITY ON PROPOSALS TO RESTRICT SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS
EXHIBIT B	POSITION OF THE CONNECTICUT DEVELOPMENT AUTHORITY ON REVENUE RULING 81-216
EXHIBIT C	LETTER FROM EXECUTIVE DIRECTOR RICHARD L. HIGGINS TO JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, REGARDING REVENUE RULING 81-216

TESTIMONY
URBAN AND RURAL ECONOMIC DEVELOPMENT SUBCOMMITTEE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
Washington, D.C.
October 5, 1981

Chairman D'Amato, Senator Weicker, members of the Subcommittee:

My name is John J. Carson, Deputy Commissioner of the Connecticut Department of Economic Development.

I am here today with Mr. Richard Higgins, Executive Director of the Connecticut Development Authority (CDA), to express the support of Governor William O'Neill and the State of Connecticut for efforts to delay implementation of the recent Internal Revenue Service (IRS) ruling (81-216) concerning small issue industrial revenue bonds.

To revoke the ruling altogether would be the most logical and appropriate action to take because (81-216) cuts into the very heart of the most justifiable of all revenue bond activities -- financing for the "little guy".

However, we appreciate the concern in the Congress over the scattered abuses in revenue bonds, and we concur that delaying the ruling until all the evidence is in concerning revenue bonds may be the best way to proceed at this time.

What troubles us in Connecticut is that the IRS has by executive fiat eliminated the best of all revenue bond programs, and truly a program to aid small, viable businesses. In effect, the abuses about which you have been hearing over these past months have been left untouched while small and medium-sized companies who need this economic encouragement the most are being penalized.

We do agree that in some cases, revenue bonds have gotten out of hand. Yet, we must stress that we believe states such as Connecticut have utilized revenue bond responsibly and effectively and should not be penalized for the excesses of others. We are also prepared to support selective restrictions in industrial revenue bond activity because we realize the need to control federal expenditures and maximize potential revenue.

Still, we are unwilling to support actions which will, in effect, "throw the baby out with the bath-water".

The time has come for this nation to get serious about the intense worldwide competition which has thrown U.S. manufacturers into an economic death struggle. We must have a rational and consistent national policy aimed at improving the competitive position of U.S. manufacturers in order that the United States can preserve and create the millions of manufacturing jobs that will be necessary in the 1980's for a healthy national economy.

Economic policy must not be shaped in back rooms, free of reasonable debate and devoid of economic understanding. Congress must package all of the necessary economic pieces in order to give impetus to a consistent national policy. This is particularly important to a state such as Connecticut, which is a heavilymanufacturing and exportoriented state. Accelerated depreciation and investment tax credits are half of the equation needed to improve productivity of U.S. manufacturers, and to get growth started again.

However, this new national thrust can be totally neutralized by the revocation or unreasonable curtailment of tax-exempt industrial revenue bonds.

Industrial revenue bonding has been an important tool for the economic revitalization in Connecticut, and has often made the difference for manufacturers faced with the decision to close or to rebuild old plants. I am certain the same is true in other older industrial areas of this nation.

United States manufacturers are facing enormous competition from overseas companies who are heavily subsidized by their own governments. It would place American industry at an even greater disadvantage if the federal government withdrew what has been its only realistic contribution to expansion and job-creating capital formation by private enterprise.

We would favor limiting the use of revenue bonds to projects which are economically justifiable. This means "multiple" issue bonds packaged in a way that the small and medium-sized manufacturer has the same access to tax-exempt financing as the large corporation such as a U.S. Steel or a General Motors. Non-recognition in the bond market and the exorbitant cost of underwriting a bond issue would make it prohibitive for the small and medium-sized business to use revenue bonds on a conventional basis. And, I can assure you that the majority of all small manufacturers using revenue bonds would be unable to undertake their projects if they had to go to the conventional lending market for loans at interest rates that are nearly double what they receive through revenue bonds. For that matter, many of these companies would not be able to obtain the loans, no matter what interest rate is charged.

That is what is so incredible about the recent IRS ruling in that (81216) eliminates the very revenue bond activity that all of us speak so highly about small business as this nation's backbone. We all say how important small business is, but, in Connecticut, we have put our money where our mouth is, and created a revenue bond program which actually helps those who need assistance.

We would support bonds also for manufacturing and distribution facilities because of the importance of these activities to the muchtouted "reindustrialization" process in this nation. We also believe revenue bonds should be available to selected commercial and retail projects in distressed urban communities only. These are areas which sorely need development as well as an extra incentive to attract such development. It is one of the few ways we can stimulate the creation of new job opportunities for our minority populations which have long been excluded from the economic mainstream.

We in Connecticut do not use revenue bonds to help construct fastfood restaurants or discount department stores in suburban shopping centers, nor any of the other abuses which have been outlined in months of testimony. Such practices are completely illogical, and we would support restrictions to target the benefits of the bonds to where they are needed the most -- small and medium-sized companies, manufacturing and distribution, and projects in our economically depressed urban areas.

Connecticut is proud of its industrial revenue bond program and makes sure that "public purpose" is the guide to a reasonable policy determination. We insert a "public purpose" call in all bond issues that requires the facility to be utilized for an eligible purpose for the life of the bond; a violation of this provision would result in withdrawal of the tax-exempt status of the bond.

We are not insensitive to the needs of the federal government to cut its costs and tighten up losses in revenue. But, it would be counter-productive to the current national drive for reindustrialization and a heightened competitive position worldwide to put into place new and innovative investment incentives and, at the same time, revoke economic stimulants such as revenue bonds which have proven to be a major asset in providing the productivity and competitiveness of U.S. manufacturers.

Thank you for your time and attention, and I and Mr. Higgins will be happy to answer any questions about Connecticut's program which you may have.

EXHIBIT A

POSITION OF THE CONNECTICUT DEVELOPMENT AUTHORITY ON PROPOSALS TO RESTRICT SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS

I. GENERAL STATEMENT OF POSITION

State-Backed IDB's. Tax-exempt small issue industrial development bonds (IDB's) are used to finance the single most important industrial and employment program in Connecticut: the Umbrella Program of the Connecticut Development Authority. The Umbrella Program is nationaly recognized for its prudent management and careful use of state assistance to small manufacturing businesses. No commercial projects are financed under the program. IDB's permit the Authority to offer below market loans to small companies for industrial projects. The loans are fully insured by a state-backed insurance fund, which improves the credit standing of Umbrella Program IDB's to a level near that of the State. This substantial contribution by the State of Connecticut to the Umbrella Program must be taken into account by Congress as it considers the IDB question. The heavy federal tax currently imposed on IDB's effectively limit the Umbrella Program loans to $850,000 or less, and the loan proceeds must be spent on plant and equipment. No further limitations should be imposed on IDB's which are state-backed, regardless of restrictions which Congress may deem appropriate for IDB's supported solely by a company's credit.

Use in Connecticut. IDB's are also used to finance the Authority's Self-Sustaining Program. Bonds issued under this Program are payable solely by the assisted company; no State credit support is pledged when the bonds are issued. Bonds under both programs have been used almost exclusively for industrial purposes in Connecticut, financing manufacturing, warehouse, research and development, and administrative facilities. The Umbrella Program and the Self Sustaining Program together have helped create or retain approximately 104,200 jobs in Connecticut since 1972.

Long experience in the State clearly demonstrates that these bonds have been necessary to bring the cost of capital within the reach of small and medium size industrial businesses. IDB's have also been instrumental in attracting overseas companies to locate manufactuting facilties in Connecticut. Without the program, much industrial expansion in the State and the employment it generated simply would not have occurred. IDB's are therefore an essential State development tool. They have been used prudently in Connecticut for carefully delineated State public purposes, and should be supported at the national level as a proven incentive to economically productive enterprise and the creation of stable employment.

Correction of Overuse. Unrestrained use of IDB's has occurred in some states. The issuance of IDB's for retail and service businesses in particular is of questionable utility. The Authority accepts the general principle of restricting the use of IDB's for such commercial purposes to distressed urban and rural areas. Such restrictions will sharply reduce IDB volume to an appropriate level. However, to avoid a long regulatory hiatus after imposing any such use restrictions, Congress must take care to address the problem of the "mixed use" facility, one which contains both eligible and ineligible uses. The State also does not object to the concept of reasonable State IDB reporting.

Federal Backlash Is Inappropriate. No other restrictions are necessary or appropriate. Directly eliminating IDB's, either now or through a sunset provision which would terminate IDB's after a certain period, would be punitive, counterproductive and unsound public policy. Further, the issue of public hearings on IDB's should properly be left to the States, as they involve purely local considerations. These and any other requirements or limitations may well have the effect of indirectly terminating IDB's by burdening issuers and companies with time and cost requirements which are unnecessary and prohibitively expensive. Such increased federal regulatory involvement would directly contravene the current national consensus for the reduction of federal red tape, paperwork and bureaucratic mandate. Proposals to "kill" IDB's, directly or indirectly through creating a procedural maze, represent a kind of kneejerk federal backlash to the now tiresome reports of alleged abuses by commercial businesses. Such a response would be blind to the value of sound and proven industrial IDB programs such as those of the Connecticut Development Authority. We hope wiser counsel will prevail. The situation calls only for carfeful reform, not dismantlement.

The Authority is particularly concerned with the assertions presented to Congress by Treasury and others regarding what they see as the federal revenue loss represented by IDB's. Revenue loss estimates are highly conjectural. Projected loss figures computed by Treasury and the Congressional Budget Office fail to take account of the fact that mumerous other tax exempt and tax shelter opportunities are available to IDB investors, who are not likely to pass them up. This is particularly true under the new tax law. Further, unfavorable market conditions are sure to restrain IDB use in the near term. These projections also assume the development of mechanisms by which current IDB holders, who have no more room for IDB investments, can clear their portfolios to make new loans. No such mechanisms have developed or are likely to.

Finally, and perhaps most importantly, federal revenue gains from IDB's have been virtually ignored, largely because they are not readily quantifiable. Income taxes, real property taxes, reduction in welfare and unemployment benefits and other revenues and savings to federal and local governments resulting from IDB generated employment are significiant offsets to any such projected losses. Merely because these revenues and savings have not been measured does not mean they do not exist and do not exceed the losses about which IDB critics speculate. The Authority urges Congress to consider any federal revenue loss projections with appropriate skepticism.

II. RESTRICTION PROPOSALS

President Reagan is expected to propose restrictions on IDB's. His recent speech on the need to balance the federal budget by altering federal tax law mentioned his desire to correct certain "abuses and obsolete incentives." Later clarification confirmed this to be a reference to IDB's. Treasury Secretary Regan reportedly has spoken of the administration's intent to eliminate IDB's immediately.

A bill to limit the issuance of tax-exempt small issue industrial development bonds already has been introduced in Congress by Representative Charles Rangel. This bill, H.R. 4420, is based on a report and recommendations of the Oversight Subcommittee to the House Committee on Ways and Means. Under its terms, federal tax law would be amended to:

- Contain no special protection for state-backed IDB programs
- Eliminate IDB's after December 31, 1983 (the "sunset provision")
- Severely restrict the financing of warehouse and distribution and research and development industrial facilities by including them in the definition of "commercial-type" projects
- For each issue, require a public hearing, the publication of findings, and a certification to the State
- Exclude the financing of retail, financial, service and administrative facilities, defined as "commercial-type projects", except in very limited "economically distressed areas"

- Restrict IDB's after December 31, 1981 (the "sunrise provision")
- Disallow IDB's intended to finance the "relocation" of a "business activity" from one state to another
- Permit IDB's for projects in all other categories, other than "commercial" (except farmland acquisition) in any jurisdictions until IDB's are terminated
- Mandate annual state reports on IDB's to the Treasury Department
- Require the Treasury Department to report and make recommendations on IDB's to the Committee on Ways and Means

III. AUTHORITY POSITION ON ADMINISTRATION PROPOSAL AND H.R. 4420

The Connecitcut Record. IDB financings by the Connecticut Development Authority have resulted in the creation of approxiamtely 29,200 jobs, the retention of approximately 75,000 jobs, and the construction or acquisition of 16 million square feet of manufacturing and related industrial floor space. The Authority, in accordance with its statutory charge of promoting employment and economic development, monitors the use of each facility it finances to assure it is used in accordance with the public purpose of the State's program. It actively assists all companies by providing information on available plant sites and labor, meeting local project requirements, and assisting in work-outs of loans to companies in distress situations. Far from representing a tax subsidy to business, IDB's are a soverign State development tool designed to promote employment and other essential state public purposes. The benefit to the private sector is incidental to the advancement of the legislatively determined public purposes of the Authority's bond program.

Ending IDB's This Fall. Any proposal to eliminate IDB's immediately is unwarranted and unwise public policy. The Authority vigorously opposes any such federal limitation. Proposals to eliminate IDB's have virtually no basis in the testimony received on the subject by the Oversight Subcommittee. As outlined in the Congressional Budget Office Study, numerous reasonable limitations are available to Congress. The Authority recognizes that some controls are necessary to restrict the use of IDB's for retail and service business projects. But termination of the whole program is a radical solution in an area where only modest adjustments are called for, and is wholly out of line in view of the relatively few abuses revealed in the Subcommittee investigation.

A program of demonstrated value for nine years like Connecticut's should not be summarily liquidated as a quick fix for the admittedly difficult problem of balancing the federal budget. Whether this goal is in fact achievable is itself open to question. The employment and industrial expansion made possible by IDB's in Connecticut are real; the budget savings by eliminating the IDB "tax expenditure" are chimerical. There is every reason to expect that IDB investors will simply find another shelter for their income, depriving Connecticut of industrial jobs and the Treasury of its illusory revenue gains. Solid, traditional business assistance programs should not be blithely discarded merely because of continuing inaccuracies in the guesswork of estimating budget deficits.

The Administration's proposal is expressly based on the supposition that the tax cuts included in the Economic Recovery Tax Act of 1981, particularly those facilitating leverage lease transactions, make IDB's expendable. Certainly many larger industries with high credit ratings will benefit substantially under the new law. But it is doubtful that the law will prove to be the panacea some think for the small and medium sized businesses receiving IDB assistance from the Authority, particularly under the Umbrella Program. Leverage lease (tax benefit) financing will typically require a borrowing of funds and, depending on the extent of the investor-lessor's investment, the payment of a return on capital, supported in either instance by the user-lessee's credit. Small and medium size industrial borrowers, with relatively weak credit standing, may be unable to interest third-party investors in their capital needs under the crush of current market conditions evidenced most prominently by record interest rates. Further, leverage lease transactions in the relatively small amounts represented by most IDB's are also unlikely to interest large investors. The lower interest loans made possible by IDB's, and the credit support furnished by the State under the Umbrella Program, may still be the "only game in town" for such companies. The IDB program is not expendable.

Ending IDB's: In 1983. Whether now or after December 31, 1983 as proposed in H.R. 4420, the Authority objects to the termination of the IDB program. A "sunset provision" for IDB's like that proposed is pernicious lawmaking. Congress should squarely face the IDB issue now, rather than perpetuate uncertainty.

The sunset law concept has utility only where the effect of a law is unknown. IDB's have been extensively studied by the

Congressional Budget Office and the Committee on Ways and Means, and much information is available. This record calls for carefully considered, reasonable limitations, and not, as the Authority's exemplary record indicates, outright repeal. The Authority has met its burden of proof and shown the value of IDB's for industrial projects and of IDB's with State backing. Forcing the Authority to seek Congressional re-authorization of IDB's in 1983 by imposing a sunset rule serves no constructive purpose, and the concept should be dismissed.

Industrial Facilities. H.R. 4420 would permit the financing of manufacturing plants but would practically eliminate IDB financing of related industrial uses, such as warehouse and distribution and research and development facilities. These industrial facilities would be erroneously classified as "commercial-type property" and confined to very narrow pockets of poverty. Financing authority for manufacturing-related activities is important in Connecticut and should not be impaired.

Procedural Burdens. H.R. 4420 would create a new paperwork blizzard at exactly the time that the federal government is attempting to reduce the burden of federally mandated record-keeping of marginal value. Before any IDB could be issued, the Authority would have to hold a public hearing, make and publish prescribed findings, and certify to the State that these procedures have been observed. It is a sure bet that Treasury regulations will compound these burdens. Further, the prescribed findings include the notion that the project "would not have been undertaken" without tax-exempt financing. It is in the end, wholly a subjective matter to make such a determination. This is another example of a legislative provision that could eliminate IDB's while the bill itself purports to allow them.

These procedural requirements would constitute an unwarranted and perhaps unprecedented intrusion of the federal government in local affairs. Using the tax code to effect this encroachment is particularly troublesome. States traditionally have been free, within the constraints of the State and federal constitutions, to establish by statute the manner in which municipal bonds are issued. It is difficult to divine any legitimate federal interest in local bond issuance procedures. Numerous state notice, hearing and "sunshine" laws exist already to protect the public interest. Imposing further layers of federal procedural mandate will create time and money costs which cannot be justified by any conceivable benefit. Protecting existing local business from IDB financed competition and demonstrating the inducement provided by IDB financing, the apparent objectives of this requirement, are more properly a state regulatory matter.

Certifications to the State that federal requirements have been met in the issuance of IDB's would also be required under H.R. 4420. Only elected bodies, or bodies established, appointed and controlled by elected bodies and officials, can issue IDB's. Direct statutory control on the membership and powers of IDB issuers thus already exists under state law. Encumbering the issuance process for each financing with certifications to the State would create barriers which are all out of proportion to any potential public benefit, unnecessary in view of existing public controls, and unjustified based on the information compiled by the CBO and the Oversight Subcommittee.

Narrowness of Economically Distressed Areas. "Commercial-type projects" would be confined under H.R. 4420 to "pockets of poverty", where 70% of the people have less than 80% of the state's median income and 30% have income below the national poverty level. This would comprise an extremely limited area in Connecticut, and is unduly restrictive. States should be free to designate the areas which they consider economically distressed based on local criteria, with a limit on the total area which can be targeted. As discussed earlier, industrial projects such as warehouses and research facilities should not be joined with fast food stands and mass merchandising stores as commercial type projects subject to locational restrictions.

Sunrise Provision. Under its "sunrise provision", H.R. 4420 would take effect after December 31, 1981 if enacted. Thus, if Congress does not act this year, IDB's issued next year would be facing the possibility that legislation with a retroactive effective date (January 1, 1982) might become law. This provision would cause a chilling effect as responsible participants took the possibility of enactment into account, and would thus have the effect of law even though Congress had not acted. This is pure subversion of the concept of due process. Laws should be effective on the date of their enactment.

Relocations. H.R. 4420 would prohibit IDB use where an issue is intended to finance the relocation of a business activity from one state to another. This test, however, like others, is sure to spawn extensive Treasury regulations, here attempting to answer the unanswerable questions of "what is a relocation" and "what is a business activity." Time, paper and costs will mount as extensive proof is adduced to satisfy the requirement, further inhibiting the utility of the program for any company with multiple-state operations. If the relocation principle is nonetheless included, satisfaction should be demonstrable through a simple "safe-harbor" affidavit of the company attesting to the absence of a relocation.

The Mixed Use Problem. Many, if not most, of the facilities financed with IDB's contain more than one use. For instance, a manufacturing plant may include warehouse, administrative or even retail space. If any such additional use is classified as a "commercial-type" use and therefore ineligible for financing, Treasury may in regulatios disqualify the entire facility unless the law specifies otherwise. The Authority recommends that, if any federal distinction is drawn between eligible and ineligible project uses, a facility be entirely financeable by IDB's if its predominent use is tax qualified. Alternatively, the entire portion of a facility containing an eligible use should be financeable with IDB's regardless of the nature or extent of any ineligible use.

IV. IDB RESTRICTIONS SUPPORTED BY THE AUTHORITY

Any Restrictions Should Be Reasonable. The Authority supports reasonable restrictions on the issuance of IDB's. Congress may consider restrictons appropriate to restrict IDB use for projects which are not directly involved in the production of, or adding of value to, tangible goods. IDB issuance authority under such circumstances be curtailed for retail, financial and service establishments as defined in Divisions G, H and I of the Standard Industrial Classification Manual. If adopted, this restriction should not apply to facilities located in targeted areas or financed by state-backed IDB's. States should be allowed in any targeting approach to designate up to 25% of the area of the state as distressed for this purpose.

Commercial Facilities. The Authority regards governmental support of basic industry, and related facilities such as those for warehousing and research and development purposes, as essential. Experience in Connecticut demonstrates the importance of IDB's as a tool in maintaining and developing the manufacturing base of the State's economy. IDB's also have been important in attracting foreign industrial development to Connecticut. The Authority believes that IDB's have been and should continue to be a vital element of the national effort to re-industrialize the United States and to assist our industries in the most competitive areas of international business.

If Congress elects to restrict IDB's for commercial purposes, ineligible facilities should be clearly circumscribed by law. The Standard Industrial Classification Manual, developed and maintained by the Office of Management and Budget and the Department of Commerce, is the best business classification reference source. SIC classifications are used by direct reference in at least two federal statutes, and in at least two instances in federal tax regulations. Restricting IDB financings for facilities falling into SIC Divisions G (Retail trade), H (Finance, insurance and real estate) and I (Services) would encompass all those business activities generally regarded as commercial. Under these limitations, IDB's could not be issued for general merchandise stores, banks, professional offices and sales and service establishments.

Manufacturing Facilitites. This approach would permit issuers to continue to finance manufacturing facilities (SIC Division D) and manufacturing related activities (wholesale trade - Division F, transportation, communication and utilities - Division E, construction - Division C, mining - Division B and agriculture, forestry and fishing - Division A). These activities are directly involved in the production of tangible products and constitute the industrial base of the nation's economy.

The Authority supports the effort made in H.R. 4420 to use the Standard Industrial Classification for definitional clarity. The inclusion by H.R. 4420 of facilities covered by SIC Division F (Wholesale trade) and Appendix A (Activities at a central administrative facility) as "commercial-type projects", however, is unduly restrictive. It would prohibit the financing of warehouse and distribution and research and development facilities.

Targeted Areas. No restrictions should be placed on IDB's in designated targeted areas. The reluctance of private enterprise to make capital investments in distressed municipalities is widely recognized. State considerations of public purpose should be permitted to govern the use of IDB's in these areas. The Authority recommends that any definition of targeted areas be left to the states, with each being permitted to establish distress criteria and designate up to 25% of the area of the state as distressed. As a less preferred alternative, targeted areas could be federally defined to include those municipalities meeting the appropriate distress criteria established by HUD for UDAG purposes. This approach is currently used in Connecticut to define areas eligible for State funded property tax abatements.

Reporting Requirements. The Authority does not object to meeting reasonable reporting requirements as to the IDB's it issues. Congress should be aware, however, that reporting requirements already exist under present law. For any issue over $1 million, all issuers must "elect" to have the complicated capital expenditure rules apply by filing a notification statement with the IRS. Treasury thus has access right now to authoritative information on all IDB's except those small issues of $1 million or less.

V. CONCLUSION

Approval of any proposal to gut the IDB program would represent a denial of the positive contributions this financing tool has made to the State and the nation. Surely these contributions are evident in Connecticut.

The Authority urges Congress to:

- Reject any proposal to kill IDB's, whether effective now or later
- Retain current law for State-backed programs
- Retain current law for manufacturing and related industrial facilities, without placing further limits on the amount of IDB's any company or state can issue
- Target IDB's for retail, finance, service and administrative facilities to distressed areas which, within limits, the states are permitted to designate
- Leave the issue of notice, hearing, findings and other procedural matters to the states
- In mixed use facilities, permit the entire facility containing predominantly a qualified use to be financed with IDB's
- Apply any restrictions when enacted, not retroactively, and exempt projects for which an issuer has adopted an official action resolution.

[illegible]

POSITION OF THE CONNECTICUT DEVELOPMENT AUTHORITY ON REVENUE RULING 81-216

Introduction. Revenue Ruling 81-216 brought the Authority's Umbrella Program to an immediate halt. It also raised numerous questions relating to issues under its Self-Sustaining Program. The Authority urges the immediate, permanent revocation of the Ruling and the regulations based on the Ruling which Treasury has announced it will issue.

The Umbrella Program. The true value of the Umbrella Program is that it provides the Authority with the ability to make relatively inexpensive funds available to small, unrated and unratable companies that otherwise would have little access to the credit markets. Our Umbrella Bonds, although marketed at the same time, are issued in separate series of $1 million or less. Individual project loans assigned to a series typically range between $300,000 and $500,000; they do not exceed $850,000 and have been as small as $70,000. Each such series, issued pursuant to a separate indenture of trust, is secured by the properties financed with the proceeds of the series and the revenues derived therefrom. There is no cross-collateralization among series. In addition, all Umbrella Bonds are secured by the State's commitment to bail-out troubled projects through the issuance, if necessary, of its own general obligation bonds. Because (1) the State's credit is pledged to the repayment of the Umbrella Bonds (2) there are many more options, and thus considerably more leverage in bringing, say, $25 million of Umbrella Bonds to market at one time than, for example, a single $500,000 bond, and (3) the transactional costs, for each $1 million series, of selling $25 million of Umbrella Bonds are less than the transactional costs of bringing a single $1 million to market, the Umbrella Program offers substantial savings to small but viable companies throughout the State that time and again have found the cost of funds in the established credit markets to be prohibitively expensive.

There can be little doubt that Rev. Rul. 81-216 reaches, and, indeed, it is our understanding that Situation 1 is specifically aimed at eliminating, our Umbrella Program and similar programs established by other State agencies. While each of the four factors "generally" to be applied in determining whether several issues are to be considered a single issue for purposes of Code §103(b) are susceptible of a multitude of interpretations and thus confusion (and this, we understand, by design), one can fairly conclude that all four are met in the case of our Umbrella Program. Our Umbrella Bonds are:

(1) sold at substantially the same time,

(2) sold under one official statement pursuant to a common plan of marketing,

(3) sold at substantially the same rate of interest, and

(4) commonly secured by the credit of the State.

The justification for Rev. Rul. 81-216 and the revocation of Rev. Rul. 74-380, Rev. Rul. 77-55 and Rev.Rul. 78-159 (which, we are advised, provide an ample legal basis for the Umbrella Program) evidently lies in the fact that "[such earlier Revenue Rulings] do not focus on the factors described in [Rev. Rul. 81-216] for deciding whether separate lots of obligations will be considered a single issue. . .", as if to suggest that the factors and the circumstances that they embrace are something new. Considering the unexpected and awesome effect of the Service's action, such a statement is shocking. The Service has long been familiar with the program of the New York Job Development Authority, on which our Program was modelled (with the knowledge of the Service). The JDA program was established in 1962 and has been the subject of five ruling requests dating back to that year. In its review of these requests, the Service has had ample opportunity to consider the factors addressed in Rev. Rul. 81-216. Given the historical basis for umbrella-type programs and the Service's active participation in their development, the stated justification for Rev. Rul. 81-216 is, at best, subject to serious question.

The Self-Sustaining Program. Whereas the impact of Situation 1 of Rev. Rul. 81-216 on the Umbrella Program is, unfortunately, very clear, the effect of the Ruling, specifically Situations 2 and 3, on our Self-Sustaining Bonds is far more difficult to measure. Consider, for example, two issues of bonds, both in excess of $1 million, the proceeds of which are loaned to two different companies (herein "Construct A"). Both companies have coincidentally received a letter of credit from the same Connecticut bank to enhance their credit standing. In addition, the bond issues are coincidentally sold on the same day to the same purchaser, and because of the credit enhancement provided by the letters of credit, bear substantially the same rate of interest. Is the existence of a common plan of marketing to be established from the point of view of the purchaser and thus, are these bonds one issue of bonds?

Consider also a transaction (herein "Construct B") in which the Authority issues its bonds, the proceeds of which are to be loaned to a corporation for the construction of a facility in Connecticut, at the same time that this corporation is participating in a bond financing of another project in another state, say, California. Assume that the two issues of bonds are closed at the same time, sold to the same purchaser, for instance, a New York bank, and bear the same rate of interest. Although Situation 2 of Rev. Rul. 81-216 involved bonds issued by political subdivisions of the same state, it is nothing more than a slight extension of Situation 2 to conclude that these two transactions are one issue of bonds. This conclusion, and, indeed, the conclusion of the Ruling in Situation 2, ignores entirely the existence of the issuers and instead treats the corporation as the obligor of the Bonds. A very similar argument has been made by the Service and recently rejected by the Tax Court in connection with small issue bonds issued to finance a project for the Federal government which the Service contended were federal obligations. In *Fairfax County Economic Development Authority v. Commissioner*, 77 T.C. No. 39 (September 2, 1981), Chief Judge Tannenwald stated that Congress had rejected this wholesale "real obligor" theory in its enactment of the IDB provisions in 1968. Said the Tax Court:

> Thus, in our judgment, by having dealt in detail with the tax status of IDBs, Congress preempted the field and effectively precluded any general adoption of the "real obligor" theory as a judicial gloss on section 103--at least insofar as the tax consequences of IDBs, as defined in the statute are concerned.

Id., at 3851.

The Service's implicit assertion of the "real obligor" theory in the context of Situation 2 of Rev. Rul. 81-216 flies in the face of the intent of Congress, as found by the Tax Court, to respect the form of transactions which meet the requirements of Section 103. Under the rationale of the *Fairfax County* decision if, as in Situation 2, each of 20 political subdivisions issues on the same day a $1 million small issue bond, the proceeds of which are to be used in a manner consistent with Code §103(b)(6), it should matter not at all who really is the real obligor. Therefore, it seems appropriate to conclude that the Connecticut and California issues are indeed separate issues for the purposes of Code §103(b).

Suppose the Connecticut-California fact situation described in Construct B, above, is extended to a situation (herein "Construct C") involving a small issue bond in Connecticut and a California pollution control financing under Code §103(b)(4)(F). If the two financings are considered one issue under Situation 2 of Rev. Rul. 81-216, should this issue be characterized as a pollution control financing or an exempt small issue? If it is a pollution control issue, it will not meet the substantially all requirement of Treas. Reg. §1.103-8(a)(1) because 90% of the proceeds will not have been spent on a qualified pollution control facility. If it is considered an exempt small issuer, who is "the issuer" for purposes of filing the statement of election under Code §103(b)(6)? Must capital expenditures in both localities be taken into account?

These issues become even more complex if a subsequent financing is done in one of the States, for example, Connecticut, for the same facility. How are the earlier issues to be treated for purposes of aggregating prior issues and capital expenditures under Treas. Reg. §1.103-10? Paragraph (d)(2) of this regulation provides that a prior issue is to be taken into account if "the proceeds of both the prior exempt small issue and of the subsequent issue. . . are or will be used primarily with respect to facilities located or to be located in the same incorporated municipality or located or to be located in the same county outside of an incorporated municipality in such county." Clearly the proceeds of the pollution financing were not used with respect to facilities in Connecticut. Yet if these two issues are considered one issue might not those proceeds have to be included in the prior issue? Further, isn't this result inconsistent with the explicit directive of Treas. Reg. §1.103-10(d)(3)(i) which provides that the prior issue provision "[does] not apply in respect of a prior issue for an exempt facility under section 103(c)(4) and §1.103-8 or for an industrial park under sections 103(c)(5) and §1.103-9, whether or not the issue might also have qualified as an exempt small issue under section 103(c)(6)(A) and this section."

Return to a consideration of Construct A involving two issues of the Authority, both in excess of $1 million for separate companies, except that no letter of credit transaction is contemplated (herein "Construct D"). The two issues are proceeding at the same pace to closing, and because both companies are of equal credit standing, the bonds will be issued at substantially the same rate of interest. Suppose, further, that the sponsor of a unit investment trust, who is seeking bonds of a certain rating closing at substantially the same time with which to the fund the trust, agrees to purchase the two otherwise unrelated bond issues. Could it be held that these bonds have been issued pursuant to a common plan of marketing because they were acquired pursuant to a common plan of the purchaser? From whose viewpoint is the common plan of marketing tested? Does a common plan of marketing require complicity among all three of the bond purchaser, issuer and ultimate borrower, or is it enough to focus on just two or even one of the three parties? If this transaction is considered to be effected pursuant to a common plan of marketing, is it now covered by Situation 3 of Rev. Rul. 81-216?

One final observation: On the facts of Situation 3 the Service concluded that a pooled security was available because under the provisions of the trust agreement (of the fixed investment trust), each certificate holder would have an individual interest in all the obligations making up the corpus of the trust. Is it fair to characterize an agreement as a pooled security which merely gives all parties the right to share pro rata in losses occasioned by default and provides no protection against such losses?

Conclusion. At bottom, Rev. Rul. 81-216 represents a superficial, unreasoned and unreasonable approach to some very basic issues which brushes aside principles of law, regulation and long standing policy almost as though they never existed. This Ruling has brought our Umbrella Program to a virtual halt, and because of the many ambiguities engendered, some of which we have attempted to share, it has had and will continue to have a substantial negative impact on our Self-Sustaining Program. We believe that these programs have proven to be a vital force in developing a strong and successful business climate in the State of Connecticut and have contributed in a meaningful way to the State's economy, and we are fully prepared to defend them in any debate on whether they or similar programs should be permitted, as a legislative matter, to continue. However, until such a debate has taken place, we should like to bring into question the wisdom of permitting (if not the raw authority of) the Internal Revenue Service to undermine so substantially these programs.

Exhibit C

cda

CONNECTICUT DEVELOPMENT AUTHORITY 210 WASHINGTON STREET HARTFORD, CONNECTICUT 06106

EDWARD J. STOCKTON, Chairman (Ex Officio)
RICHARD L. HIGGINS, Executive Director (203) 566-4320

September 1, 1981

The Honorable John E. Chapoton
Assistant Secretary for Tax Policy
Treasury Department
Room 3120
15th and Pennsylvania Avenue N.W.
Washington, D.C. 20226

Dear John:

Thank you for the meeting last week regarding Revenue Ruling 81-216, which you were kind enough to arrange on extremely short notice. We felt the conference was quite constructive and we very much appreciate your candor and receptiveness to our concerns.

The impact of the ruling on the Umbrella Program of the Connecticut Development Authority has devastating short-term impact on over 150 small businesses in the State. These firms are relying on CDA's commitment to permanently fund projects already under construction, and many of these companies are very small and have no conventional financing alternative if CDA is not able to close their loan. In the long term, the ruling seriously jeopardizes the single most important small business development program in the State of Connecticut.

I must reemphasize our shock and disappointment that the Treasury Department could instantaneously reverse a direction and policy that has been the subject of numerous rulings over the past eight years upon which the Umbrella Program was based.

Our purposes in meeting with you were twofold. First and foremost is the immediate need to seek relief with regard to outstanding bond anticipation notes and loan commitments. We are preparing and will submit this week a request for a ruling that Revenue Ruling 81-216 will not impair the exemption of interest on bonds issued to refund Umbrella Program bond anticipation notes and on notes and refunding bonds issued to fulfill loan commitments, in each case outstanding on August 24, 1981. As indicated at our meeting, bond anticipation notes are outstanding in the amount of $16,568,000, and the Authority has made approximately $73,000,000 in loan commitments. We are hopeful that the Service will move forward on an expedited basis to grant transitional relief.

Our second purpose for the meeting was to gain an understanding of the Department's perspective in reversing long-standing tax policy and to begin a review of the applicability of the ruling to CDA's Umbrella Program. It is imperative to our State that a way be found to allow the Umbrella Program to continue. Since its inception in 1972 this program has assisted over 500 firms involving 28,000 jobs in Connecticut. The state's commitment to this program is evidenced through its insurance of the underlying loans and a commitment to issue $300,000,000 in general obligation bonds of the state if necessary. No other economic development program in Connecticut carries that magnitute of state commitment. The program is restricted legislatively to industrial plants and warehouses only, and no retail, commercial, agricultural, or other facilities are financed. Hundreds of small firms have been assisted resulting in excess of 10,000,000 square feet of new facilities being acquired for small businesses. All this is now jeopardized by the Service's ruling. As indicated we are particularly troubled by the precipitousness with which the law was changed. We understand that the New York Job Development Authority received four private rulings between 1962 and 1972 with respect to a similar program. When undertaking the Umbrella program in 1972, officials of the Service advised us that a program modeled after the JDA would comply with the law. Additionally, since 1972 several revenue rulings have been promulgated which provided direct legal support for the manner in which our program has been structured. It is our belief that the Umbrella program is fully consistent with national goals of industrial and small business revitalization and stands out as a national example of how a good IRB program can be administered. If we are forced to, we will attempt to conduct the program on a loan-by-loan basis without a common plan of marketing for the refunding bonds. The main effect of the absence of centralized loan packaging will be to increase to an almost prohibitive level the transaction costs for our smallest loans. This kind of punitive result for small businesses surely was not fully considered when the ruling was promulgated.

We ask your assistance in finding a reasonable way to preserve our Umbrella program. Eric Petersen, Jay Eustis, or I would be pleased to either provide you with additional information or work with you in developing alternatives that permit this important effort to continue in Connecticut.

I look forward to hearing from you in the near future and again thank you for your time and attention last week in listening to our concerns.

Sincerely,

/s/ Richard L. Higgins
Executive Director
(203)566-4320

RLH:mr

cc: Mr. John E. Theberge
Senior Technical Advisor
Room 5312
Internal Revenue Service Building
1111 Constitution Avenue N.W.
Washington, DC 20224

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STATEMENT

RONALD BEAN

PRESIDENT, COUNCIL OF POLLUTION CONTROL FINANCING AGENCIES

EXECUTIVE DIRECTOR, ILLINOIS ENVIRONMENTAL FACILITIES FINANCING AUTHORITY

BEFORE HEARINGS OF THE

SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT

COMMITTEE ON SMALL BUSINESS

UNITES STATES SENATE

October 5, 1981

1015 18TH STREET, N.W. • SUITE 200 • WASHINGTON, D.C. 20036 • (202) 659-2498

Mr. Chairman, I am Ronald Bean, Executive Director of the Illinois Environmental Facilities Financing Authority, and President of the Council of Polluton Control Financing Agencies. The Council is composed of state and local public agencies who serve as issuers of pollution control financings. The member agencies of the Council accounted for over thirty percent of the recorded pollution control financings for 1980.

As public officials, many of us are institutionally linked with our state and local economic development efforts. Our purpose is to foster the availability of capital for industry to meet the ambitious environmental goals set forth in national laws. For me and many of my counterparts across the country, this has special importance for the small businesses in our jurisdiction.

I will leave to others the details of how small business simply does not have equal access to capital, and how the industrial development bond financing method has been able to help them gain some parity. I want to emphasize that this applies with double force for small businesses ordered to meet pollution control mandates. For a business which has limited or no access to capital markets, an order to install an expensive, non-productive facility is a death sentence.

Fortunately, the existence of the Small Business Administration's Pollution Control Loan Guarantee Program and the ability to aggregate issues into financings of a marketable size have been able to overcome this burden for many small businesses. The result has been that jobs have been preserved, or created, while environmental goals have been attained.

Much has been said of the benefits which will flow to industry from recently enacted tax legislation. Close examination, however, will show that less than a proportional share of such benefits will go to the small businesses caught in the national economic turmoil, even though it is just those companies that will generate the jobs and economic activity which will make the differnce in a national turnaround.

A case in point is the Treasury's recent ruling, now to become a regulatory proposal, which in effect cancels much of our ability to combine small financings. It serves no purpose, environmentally or economically. It was done suddenly, posing a serious threat to current plans of many businesses, and it has been left in effect, pending final regulatory action.

The ability to aggregate issues is crucial to the success of the SBA program, which this committee has strongly supported. The Council has applauded your action to increase the ceiling on the program to $250 million per year. In testimony on that issue, I presented the committee with numerous case histories from Council members. A copy of the testimony accompanies this statement, and I will not repeat them, but I would like to illustrate one case, for the committee's benefit.

Del Mar Plating, in Franklin Park, Illinois, has eighteen employees. It needed $180,000 for equipment to meet air and water pollution control requirements. Fred DeMaria, the company's President, said he was able to find commercial bank loans available only at 23 percent, with a maximum seven year payback. He said "While the price alone made the heart flutter, the interest rates were ample incentive for cardiac arrest." Remember, this is for equipment which is not going to produce any income for the company.

We were able to arrange financing of the $180,000 by combining it with a financing of $2.4 million for another company and going to the market with a combined issue of $2,580,000. Mr. DeMaria says, "I really couldn't pay the commercial bank rates, they are devastating. And I don't think the business could have continued to make it."

All in all, the illinois Environmental Facilities Financing Authority has issued $21,347,000 in bonds for financings for 29 companies, with a total of 2,092 employees. The jobs are still there, the environmental mandates are being met the funds are being repaid without a single default, and, as I pointed out in my previous testimony, the Federal Treasury has realized a net gain through operation of this program. None of this would have been possible under the suspension of the ability to combine loans which is now in force.

Finally, I want to touch on a larger issue, the continued opposition of the Treasury to tax-exempt financing. The Council is deeply suspicious of the tax expenditure estimates produced by opponents of such financing. The Congressional budget office, while perpetuating such estimates in its own report on the subject, stopped short of promising that eliminating IDB fnancing will therefore mean a corresponding increase in revenues. I can guarantee, however, that if such financings are eliminated, by legislation or by unilateral administrative actions, small business will be denied equal access to capital in a period when that means the difference between success and failure for our nation's economy, and the local economies of many of our communities. The Council shares the concern of this committee, and offers whatever support we can provide for your continuing oversight.

I thank you for the opportunity to appear, and would be glad to answer any questions you may have.

OFFICIAL STATEMENT

TWO NEW ISSUES

Interest exempt, in the opinion of Bond Counsel, from present Federal income taxes under existing statutes, court decisions, regulations and rulings, except as provided in Section 103 of the Internal Revenue Code as to any Bond held by a substantial user of the project or by a related person. See "Tax Exemption" herein.

$2,580,000

Illinois Environmental Facilities Financing Authority

Small Business Pollution Control Revenue Bonds

consisting of:

$2,400,000
American Fly Ash Company Project

$180,000
Del Mar Plating & Anodizing Co. Project

Dated: September 1, 1980

Due: September 1 of the years shown below:

The proceeds of the Bonds will fund a loan to one of the two companies identified herein for the purpose of providing financing for that particular company's pollution control project. The Bonds are special revenue obligations of the Illinois Environmental Facilities Financing Authority (the "Authority") payable solely from revenues derived under the terms of a Loan Agreement and a Promissory Note delivered by the particular company whose project is being financed thereby. THE BONDS ARE NOT GENERAL OBLIGATIONS OF THE AUTHORITY OR OF THE UNITED STATES OF AMERICA, AND ARE NOT SECURED BY THE FULL FAITH AND CREDIT OR TAXING POWERS OF ANY FEDERAL, STATE OR LOCAL GOVERNMENT OR AGENCY.

Each company's Promissory Note is payable in installments of principal and interest sufficient in amount to provide revenues for the payment when due (including mandatory sinking fund redemptions) of the principal of and interest on the Bonds. THE OBLIGATION OF THE BORROWER TO PAY THE PRINCIPAL OF AND INTEREST ON ITS PROMISSORY NOTE WILL, PURSUANT TO SECTION 404(b)(2) OF THE SMALL BUSINESS INVESTMENT ACT OF 1958, AS AMENDED, BE GUARANTEED BY THE UNITED STATES SMALL BUSINESS ADMINISTRATION. The guaranty by the United States Small Business Administration is a full faith and credit obligation of the United States.

Principal and semiannual interest (due on each March 1 and September 1, commencing March 1, 1981) are payable at the principal corporate trust office of Central National Bank in Chicago, Chicago, Illinois, as Trustee. Coupon Bonds in the denomination of $5,000 each, registrable as to principal only, and fully registered Bonds without coupons in denominations of $5,000 or any multiple thereof, are exchangeable at the principal corporate trust office of the Trustee. The Bonds are subject to redemption prior to maturity, including mandatory sinking fund redemption for Bonds having a stated maturity of September 1, 2000, all as more fully described therein on pages 7 through 10.

$360,000 SERIAL BONDS

Maturity Date (September 1)	Interest Rate	Principal Amount American Fly Ash Bonds
1981	6.00%	$50,000
1982	6.15	55,000
1983	6.30	60,000
1984	6.45	60,000
1985	6.60	65,000
1986	6.80	70,000

$2,220,000 9.00% TERM BONDS Due September 1, 2000
consisting of:
$2,040,000 Principal Amount American Fly Ash Bonds
$180,000 Principal Amount Del Mar Bonds

PRICE OF ALL BONDS: 100%, plus accrued interest

The Bonds are offered when, as and if issued and received by the Underwriter, subject to prior sale, to withdrawal or modification of the offer without notice and to certain conditions including the unqualified approval of legality by Foley, Lardner, Hollabaugh & Jacobs, Washington, D.C., Bond Counsel.

Delivery of the Bonds in definitive form is expected on or about September 25, 1980. Subject to applicable securities laws and market conditions, the Underwriter intends, but is not obligated, to make a market in the Bonds. It is not anticipated that any other secondary market will develop for the Bonds. For information with respect to the Underwriter and its compensation, see "Underwriting" herein.

FIRST WISCONSIN
MILWAUKEE

September 3, 1980

No dealer, broker, salesman or other person has been authorized by the Authority, any Borrower, the United States Small Business Administration or the Underwriter to give any information or to make any representations, other than those contained in this Official Statement, and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information contained herein concerning the individual Projects and the uses of the Proceeds of each issue and the information contained in Appendix A concerning each individual Borrower has been obtained individually from each Borrower and is believed to be reliable but is not guaranteed as to accuracy and completeness by, and is not to be construed as a representation by, the Authority or the Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the parties referred to above or that the other information or opinions are correct as of any time subsequent to the date hereof.

TABLE OF CONTENTS

	Page
Introduction	3
Separateness of Bond Issues	3
Use of Certain Terms	3
The Authority	5
Use of Proceeds	5
Source of Payment and Security for the Bonds	5
Summary and Description of the SBA Guarantees	6
Description of Certain Terms of the Bonds	7
Redemption of Bonds Prior to Maturity	7
Summary of the Promissory Notes	10
Summary of the Loan Agreements	10
Summary of the Indentures	12
Tax Exemption	15
Legal Matters	16
Underwriting	16
Discussion of Bond Ratings	17
Miscellaneous	17
Appendix A—Description of the Borrowers and the Projects	A-1
Appendix B—Form of SBA Guaranty	B-1

$2,400,000

Small Business Pollution Control Revenue Bonds
Illinois Environmental Facilities Financing Authority
(American Fly Ash Company Project)
(herein called the "American Fly Ash Bonds")

$180,000

Small Business Pollution Control Revenue Bonds
Illinois Environmental Facilities Financing Authority
(Del Mar Plating & Anodizing Co. Project)
(herein called the "Del Mar Bonds")

INTRODUCTION

Purpose

This Official Statement is for the purpose of setting forth information concerning the issues of Bonds identified above.

The American Fly Ash Bonds will be issued by the Authority in the aggregate principal amount of $2,400,000 to finance a pollution control project for the American Fly Ash Company, an Illinois corporation (the "Borrower").

The Del Mar Bonds will be issued by the Authority in the aggregate principal amount of $180,000 to finance a pollution control project for Del Mar Plating & Anodizing Co., an Illinois corporation (the "Borrower").

Separateness of Bond Issues

The American Fly Ash Bonds, and the Del Mar Bonds will constitute two separate issues of Bonds. Each issue of Bonds is separately secured and is governed by separate documentation. Although the terms and provisions of the documentation for each issue of Bonds are substantially the same (identical for the most part), the parties to each Bond issue will exercise their respective rights and obligations entirely independently of the parties to the other Bond issues. Thus, for example, the Bonds of one issue may be redeemed prior to maturity where the Bonds of other issues are not, or a particular default in respect of Bonds of one issue would not necessarily constitute a default in respect of Bonds of other issues.

Use of Certain Terms

As used in this Official Statement, the term "Bonds" will refer to the American Fly Ash Bonds or the Del Mar Bonds and will be used in the context of descriptions which are common to both issues.

The term "Authority" will refer to the Illinois Environmental Facilities Financing Authority, a body politic and corporate and a public instrumentality of the State of Illinois created by the Illinois Environmental Facilities Financing Act, Illinois Revised Statutes, 1979, Chapter 127, Section 721 *et seq.*, as amended.

The term "Borrower" will refer to American Fly Ash Company or Del Mar Plating & Anodizing Co., and will be used in the context of descriptions which are common to both parties.

As used in this Official Statement, the defined terms "Indenture", "Loan Agreement", "Promissory Note", "SBA Guaranty", "Project" and "Plant Complex" are used in the context of a description common to both Bond issues. Where a description is unique to a particular one of the Bond issues, such defined terms will be modified with the name of the particular Borrower whose financing is being described (*e.g.*, the "American Fly Ash Indenture", the "Del Mar Loan Agreement", the "American Fly Ash Project", the "Del Mar SBA Guaranty", etc.).

Financing Structure

The Bonds of each issue will be issued under and secured by a separate Indenture of Trust, dated as of September 1, 1980 (the "Indenture"), between the Authority and Central National Bank in Chicago, Chicago, Illinois, as trustee (the "Trustee"). The Trustee will act as registrar of and paying agent for the Bonds. For further information regarding the Indentures, see "SUMMARY OF THE INDENTURES" herein.

Prior to the issuance of its Bonds, the Authority will enter into a Loan Agreement, dated as of September 1, 1980 (the "Loan Agreement"), with each Borrower. The Loan Agreement obligates the Authority to lend the proceeds from the sale of the Bonds to the Borrower for the purpose of financing the Borrower's Project. For further information regarding the Loan Agreements, see "SUMMARY OF THE LOAN AGREEMENTS" herein.

As evidence of its loan, each Borrower will execute, issue and deliver its promissory note, dated September 1, 1980 (the "Promissory Note"), payable to the order of the Authority in the principal amount of the loan, maturing in 240 consecutive, substantially level, monthly installments of principal and interest which will provide the Authority with revenues sufficient to pay when due (including mandatory sinking fund redemptions) the principal of and interest on its Bonds. For further information regarding the Promissory Notes, see "SUMMARY OF THE PROMISSORY NOTES" herein.

Each Borrower is required under the terms of its Loan Agreement to apply the loan proceeds to the costs of acquiring and installing certain pollution control facilities (the "Project") at its plant (the "Plant Complex"). For a description of each Project and its estimated cost, see Appendix A hereto.

Pursuant to a Pollution Control Facility Payment Guarantee (the "SBA Guaranty"), the payments of the principal of and interest on each Promissory Note will be guaranteed by the United States Small Business Administration (the "SBA"). The full faith and credit of the United States are pledged to the obligations of the SBA under the SBA Guaranty. No other obligations of the Borrower under the Loan Agreement are guaranteed by the SBA. For further information regarding the SBA Guaranty, see "SUMMARY OF THE SBA GUARANTEES" herein.

The Promissory Note and all of the Authority's right, title and interest in and to the Loan Agreement (except for its right to receive certain fees, expenses and indemnity payments, and to enforce certain covenants of the Borrower) and the SBA Guaranty will be pledged and assigned to the Trustee under the Indenture as security for the payment of the related issue of Bonds.

The Bonds will be issued pursuant to and in full compliance with the Constitution and laws of the State of Illinois, particularly the Illinois Environmental Facilities Financing Act, Illinois Revised Statutes, 1979, Chapter 127, Section 721 *et seq.*, as amended, and pursuant to resolutions of the Authority. THE BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM THE REVENUES DERIVED OR RESULTING FROM THE LOAN AGREEMENT AND THE PROMISSORY NOTE. THE BONDS AND ANY INTEREST COUPONS APPERTAINING THERETO SHALL NOT CONSTITUTE OR GIVE RISE TO A PECUNIARY LIABILITY OF THE AUTHORITY OR THE STATE OF ILLINOIS OR A CHARGE AGAINST THE GENERAL CREDIT OR TAXING POWERS OF THE STATE OF ILLINOIS.

This Official Statement contains brief descriptions of the Authority, the Source of Payment and Security for the Bonds, the Bonds, the Promissory Notes, the SBA Guarantees, the Loan Agreements and the Indentures. The descriptions and summaries of documents herein do not purport to be comprehensive or definitive and reference is made to each document for the complete details of all terms and conditions. Terms not defined herein shall have the meanings set forth in the respective documents. The statements contained in the first paragraph on the front cover page of this Official Statement and under the headings "INTRODUCTION", "DESCRIPTION OF CERTAIN TERMS OF THE BONDS", "SUMMARY OF THE PROMISSORY NOTES", "SUMMARY OF THE LOAN AGREEMENTS", "SUMMARY OF THE INDENTURES", and "TAX EXEMPTION" have been reviewed by Foley, Lardner, Hollabaugh & Jacobs, Washington, D.C., Bond Counsel, who are of the opinion that such statements are accurate statements or summaries of the matters set forth therein and fairly present the information purported to be shown. All statements herein are qualified in their entirety by reference to each such document. See "MISCELLANEOUS" for information regarding availability of the documents.

THE AUTHORITY

The Authority is a body politic and corporate and a public instrumentality of the State of Illinois duly organized and existing under the Illinois Environmental Facilities Financing Act, Illinois Revised Statutes, 1979, Chapter 127, Section 721 *et seq.*, as amended (the "Act"). Pursuant to the Act, the Authority is empowered to acquire, construct, reconstruct, repair, alter, improve, extend, own, finance, lease, sell and otherwise dispose of pollution control and surface mined land reclamation facilities ("Environmental Facilities").

The Act expresses the intent of the General Assembly of the State of Illinois that the Authority give special consideration to small businesses in authorizing the issuance of bonds for the financing of Environmental Facilities in order to assist small businesses in surviving the economic burdens imposed upon them by the required financing of such Environmental Facilities. In fulfilling that mandate, the Authority has collaborated with departments of State government, business associations and financial institutions (both within and outside Illinois) in a continuing effort to inform smaller business enterprises of the potential advantages of tax-exempt revenue bond financing. The Authority has also been working with the SBA in structuring financings employing guarantees by the SBA.

The Authority will continue to seek out businesses which qualify for the type of financing described herein.

USE OF PROCEEDS

The entire amount of the proceeds from the sale of each issue of Bonds (exclusive of accrued interest) will be loaned to the Borrower on the date of closing. The Underwriter's discount will be deemed to have been loaned to the Borrower and applied for its benefit. The amount deposited in the Escrow Fund will be used as a debt service reserve fund as more fully described elsewhere herein. The remaining proceeds will be held in the custody of the Trustee and disbursed as the Bond issuance costs and the Project costs are incurred. The respective Borrowers anticipate that their loan proceeds will be applied approximately as follows:

	American Fly Ash Bonds	Del Mar Bonds
Project Costs Being Financed	$2,076,836	$138,069
Deposit to Escrow Fund	65,024	4,922
Underwriter's Discount (1.5%)	36,000	2,700
SBA Guarantee Fee*	179,790	13,609
SBA Processing Fee*	900	900
Underwriter's Management Fee*	18,000	1,800
Trustee's Acceptance Fee*	1,250	1,250
Legal, Printing and Misc.*	22,200	16,750
	$2,400,000	$180,000

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* Denotes amounts deposited in the Expense Fund.

SOURCE OF PAYMENT AND SECURITY FOR THE BONDS

Source of Payment

The Bonds will be special revenue obligations of the Authority payable solely from (i) income and revenues derived pursuant to the terms of the Loan Agreement, including without limitation all payments made by the Borrower on or in respect of the Promissory Note, (ii) payments on the SBA Guaranty, and (iii) moneys and securities held in trust by the Trustee under the Indenture, and investment earnings thereon.

The Bonds do not constitute an indebtedness of the Authority or the State of Illinois and shall not constitute or give rise to a charge against the general credit or taxing powers of the State of Illinois.

Security

Under the terms of the Loan Agreement the Borrower is unconditionally obligated to provide the Authority with revenues sufficient to pay when due the principal of, premium, if any, and interest on the Bonds.

As security for the payment of the Bonds, the Authority will pledge and assign to the Trustee all of its right, title and interest in and to the Promissory Note, the Loan Agreement (except for its right to receive certain fees, expenses and indemnity payments, and to enforce certain covenants of the Borrower), the SBA Guaranty and the moneys and securities held in trust by the Trustee under the Indenture. The Loan Agreement and the Indenture provide that the Trustee may enforce the Loan Agreement, the Promissory Note and the SBA Guaranty for the benefit of the Bondholders.

The Bonds are not secured by a mortgage on or a security interest in any property of the Borrower. The SBA has required, as a condition to the issuance of the American Fly Ash SBA Guaranty, a first lien security interest in all property financed with proceeds of the American Fly Ash Bonds. The SBA has required, as a condition to the issuance of the Del Mar SBA Guaranty, personal indemnification by the owners of Del Mar Plating & Anodizing Co.

SUMMARY AND DESCRIPTION OF THE SBA GUARANTEES

The SBA Guaranty is issued pursuant to the authority vested in the SBA by Section 404 of the Small Business Investment Act of 1958, as amended, which provides that any guarantee issued thereunder "shall be a full faith and credit obligation of the United States".

The SBA Pollution Control Financing Guaranty Program is authorized under P.L. 94-305. This statute also authorized a separate revolving fund within the Treasury of the United States for the purpose of paying expenses of the program and paying any claims under guarantees resulting from defaults under financing contracts. The Congress appropriated $15,000,000 to establish the fund. Additionally, the guarantee fees, the administrative and processing fees, and any moneys, property or assets derived from operations of the program are also credited to the fund. In the event that the fund were to be depleted, additional appropriations would be required to be authorized and made to provide for the payment of any future claims under the guarantees. In the absence of such an appropriation, recourse to the Court of Claims is available. Under the authority of P.L. 95-563, judgment rendered by that court is payable out of any money in the Treasury not otherwise appropriated. According to the SBA (a) on June 30, 1980, the fund had a balance of approximately $22,419,900; (b) as of June 30, 1980, the SBA has issued guarantees for 126 companies with an aggregate amount of payments guaranteed of approximately $217,109,877; (c) as of the date hereof, the SBA has been called upon to make a payment under one guarantee and the payment has been made.

Under the SBA Guaranty the SBA guarantees the Borrower's payment of the principal of and interest on the Promissory Note. The SBA Guaranty is made to the Authority and is assigned under the Indenture to the Trustee. Any payments by the SBA under the SBA Guaranty are required to be made to the Trustee prior to interest and principal payment dates on the Bonds. The SBA Guaranty is limited to the payment of the principal of and interest on the Promissory Note and does not cover any redemption premiums on the Bonds, any Trustee's fees and expenses or any other amounts payable by the Borrower under the Loan Agreement. The SBA Guaranty is not a guarantee of the Bonds. There is no liability under the SBA Guaranty to any Bondholder by the United States or any agency thereof, and in any event no personal liability to anyone by any officer or employee of the United States or any agency thereof.

The SBA Guaranty is not an unconditional obligation of the SBA. It is a condition precedent to payments by the SBA under the SBA Guaranty that the SBA be notified of a default in the payment of the principal of and interest on the Promissory Note, that the Escrow Fund be fully applied toward curing such default and (provided that the SBA had made an affirmative determination during the processing of the Borrower's application that losses shall be mitigated) that the Trustee shall have utilized the entire period for which there are funds available in the Escrow Fund in reasonable diligent efforts to eliminate or minimize losses. The Indenture requires the Trustee to comply with such conditions. Moreover, the terms of the SBA Guaranty do not contain a waiver of any suretyship defenses that may be available to the SBA in connection with its obligations under the SBA Guaranty. As applied to the SBA Guaranty, a suretyship defense may be characterized as follows: if (whether in its own discretion or by Bondholder direction) the Trustee takes any action injurious to the SBA or inconsistent with the SBA's rights, or if the Trustee fails to take a required action and such omission increases the SBA's risk or otherwise injures the SBA's rights, the SBA may assert a right to be discharged to the extent of the injury the SBA has thus sustained. The Indenture requires the Trustee to obtain the prior written approval of the SBA before consenting to any amendment, change or modification of the terms of the Loan Agreement or Indenture, or taking any other action not expressly permitted by the terms of the Loan Agreement or Indenture.

To obtain the SBA Guaranty, the Borrower will pay the SBA the "SBA Guarantee Fee" and the "SBA Processing Fee" identified herein under the caption "USE OF PROCEEDS" and will deposit an amount equal to one-fourth of the average annual debt service requirement into the Escrow Fund established under the Indenture. Moneys available in the Escrow Fund will be applied toward any defaults by the Borrower in its payment of the principal of and interest on the Promissory Note. The Borrower is obligated to replenish the Escrow Fund for any amounts used to cure defaults in the payment of the principal of and interest on the Promissory Note.

In the event of a payment by the SBA under the SBA Guaranty, the Borrower has consented to the SBA's succession to the rights of the Authority (or the Trustee) for the purpose of collecting from the Borrower the payments of principal and interest due and payable on the Promissory Note which are in arrears and with respect to which the Authority (or the Trustee) has received payment under the SBA Guaranty.

The form of the "Pollution Control Facility Payment Guarantee" and the form of the opinion of the General Counsel of the SBA, both of which will be delivered at the time of closing, are attached hereto as Appendix B.

DESCRIPTION OF CERTAIN TERMS OF THE BONDS

The Bonds shall mature on the respective dates and in the respective amounts and shall bear interest from their date payable semiannually on the dates and at the respective rates per annum, all as set forth on the cover page of this Official Statement.

The Bonds are issuable in the form of coupon Bonds, registrable as to principal only, in the denomination of $5,000 each, or as fully registered Bonds without coupons, in the denomination of $5,000 or any whole multiple thereof. Coupon Bonds and fully registered Bonds are exchangeable at the principal corporate trust office of the Trustee. The Trustee is not obligated to make any registration or transfer of any Bonds during the 10 days next preceding an interest payment date or next preceding any selection by lot of Bonds called for redemption, or of any particular Bond after such Bond has been called for redemption. For every registration, exchange or transfer of Bonds the Trustee may make a charge sufficient to reimburse it for any tax, fee or other governmental charge required to be paid with respect to such registration, exchange or transfer. In the event any Bond is mutilated, lost, stolen or destroyed, the Authority may execute and the Trustee may authenticate a new Bond of like maturity and denomination in accordance with the provisions therefor in the Indenture, and the Trustee may charge the holder or owner of such Bond with its reasonable fees and expenses in this connection, and the Trustee may require satisfactory indemnity in the case of Bonds lost, stolen or destroyed.

REDEMPTION OF BONDS PRIOR TO MATURITY

The Bonds are not callable for redemption prior to maturity, except as described below under "Optional Redemption", "Mandatory Sinking Fund Redemption", "Extraordinary Event Redemption" and "Mandatory Redemption in the Event of a Tax Violation".

Optional Redemption

On and after September 1, 1990, the Bonds are subject to redemption prior to maturity at the option of the Borrower, as a whole on any date, or in part (in multiples of $5,000) on any interest payment date in inverse order of maturity and within a maturity by lot. The redemption price in such event shall be 100% of the principal amount of the Bonds so redeemed, plus accrued interest to the date of redemption, plus the following respective premiums (expressed as a percentage of the principal amount of Bonds so redeemed):

Redemption Period (both dates inclusive)	Redemption Premium
September 1, 1990 through August 31, 1991	3.0%
September 1, 1991 through August 31, 1992	2.5
September 1, 1992 through August 31, 1993	2.0
September 1, 1993 through August 31, 1994	1.5
September 1, 1994 through August 31, 1995	1.0
September 1, 1995 through August 31, 1996	0.5
September 1, 1996 and thereafter	None

Mandatory Sinking Fund Redemption

The Bonds having a stated maturity of September 1, 2000 are subject to mandatory redemption by operation of a sinking fund, in part by lot, at a redemption price of 100% of the principal amount of the Bonds so redeemed, and without premium, in the amounts and on the dates as follows (subject to certain credits as described below):

	Principal Amounts		
Sinking Fund Redemption Date	American Fly Ash Bonds	Del Mar Bonds	Total
September 1, 1981		$ 5,000	$ 5,000
September 1, 1982		5,000	5,000
September 1, 1983		5,000	5,000
September 1, 1984		5,000	5,000
September 1, 1985		5,000	5,000
September 1, 1986		5,000	5,000
September 1, 1987	$ 80,000	5,000	85,000
September 1, 1988	85,000	5,000	90,000
September 1, 1989	95,000	5,000	100,000
September 1, 1990	105,000	5,000	110,000
September 1, 1991	115,000	10,000	125,000
September 1, 1992	125,000	10,000	135,000
September 1, 1993	135,000	10,000	145,000
September 1, 1994	145,000	10,000	155,000
September 1, 1995	155,000	10,000	165,000
September 1, 1996	170,000	15,000	185,000
September 1, 1997	185,000	15,000	200,000
September 1, 1998	200,000	15,000	215,000
September 1, 1999	215,000	15,000	230,000
September 1, 2000	230,000	20,000	250,000

At the option of the Borrower, the principal amount of the Bonds to be redeemed on any particular sinking fund redemption date may be reduced by the principal amount of any such Bonds which (i) had been purchased by the Borrower or the Trustee and canceled by the Trustee at least 60 days prior to such sinking fund redemption date and (ii) had not previously formed the basis for such credit.

Extraordinary Event Redemption

The Bonds are subject to redemption at any time, in whole but not in part, at 100% of the principal amount, plus accrued interest to the date of redemption, and without premium, if the Borrower exercises its option to prepay the entire unpaid principal and interest balance on the Promissory Note upon or within one year following the occurrence of any of the following events:

(a) The Project or the Plant Complex shall have been damaged or destroyed to such extent that, in the opinion of the Borrower expressed in a certificate filed with the Authority and the Trustee following such damage or destruction (i) it is not practicable or desirable to rebuild, repair or restore the Project or the Plant Complex within a period of six consecutive months following such damage or destruction or (ii) the Borrower is or will be thereby prevented from carrying out its normal operations at the Plant Complex for a period of at least six consecutive months; or

(b) Title to, or the temporary use of, all or substantially all the Project or the Plant Complex shall have been taken under the exercise of the power of eminent domain by any governmental authority, or person, firm or corporation acting under governmental authority, such as results or is likely to result, in the opinion of the Borrower expressed in a certificate filed with the Authority and the Trustee, in the Borrower being thereby prevented from carrying on its normal operations at the Plant Complex for a period of at least six consecutive months; or

(c) As a result of any changes in the Constitution of Illinois or the Constitution of the United States of America or of legislative or administrative action (whether state or federal) or by final decree, judgment or order of any court or administrative body (whether state or federal) the Loan Agreement shall have become void or unenforceable or impossible of performance in accordance with the intent and purposes of the parties as expressed in the Loan Agreement, or unreasonable burdens or excessive liabilities shall have been imposed on the Borrower or the Authority, including without limitation the imposition of federal, state or other ad valorem, property, income or other taxes not being imposed on the date of the Loan Agreement; or

(d) Any court or administrative body of competent jurisdiction shall enter a judgment, order or decree requiring the Borrower to cease all or any substantial part of its operations at the Plant Complex to such extent that, in the opinion of the Borrower expressed in a certificate filed with the Authority and the Trustee, the Borrower is or will be thereby prevented from carrying on its normal operations at the Plant Complex for a period of at least six consecutive months.

Mandatory Redemption in the Event of a Tax Violation

The Bonds are subject to mandatory redemption prior to maturity in the event a Tax Violation (as defined below) shall be deemed to have occurred. The redemption price in such event shall be 100% of the principal amount thereof, plus accrued interest to the redemption date.

In such event, the Borrower shall be obligated to prepay the Promissory Note together with accrued interest. The consent of the SBA to prepayment in such event is not required, and payment of the entire amount due in such event is guaranteed by the SBA.

"Tax Violation" means the circumstance of interest paid or payable on any bond becoming includable for Federal income tax purposes in the gross income of any Bondholder (other than a Bondholder who is a "substantial user" or "related person" within the meaning and for the purposes of Section 103(b) of the Internal Revenue Code and the applicable regulations thereunder) as a result of the failure by the Borrower to observe or perform any covenant or agreement contained in the Loan Agreement or any act, omission or event whatsoever within the control of the Borrower.

A Tax Violation shall be deemed to have occurred on the earliest of the following dates: (a) on that date when the Borrower, the Authority or the Trustee shall receive notice from the Commissioner, any District Director or other authorized official of the Internal Revenue Service to the effect that a Tax Violation has occurred; or (b) on that date when the Borrower files any statement, supplemental statement of other tax schedule, return or document which discloses that a Tax Violation has occurred; or (c) on that date when the Trustee shall receive notice from any Bondholder to the effect that the Internal Revenue Service has assessed as includable in the gross income of such Bondholder any interest on any Bond due to the occurrence of a Tax Violation; or (d) on that date when the Borrower files a Borrower's Certificate with the Authority and the Trustee stating that a Tax Violation has occurred.

In the event a Tax Violation shall be deemed to have occurred, the Borrower is obligated to pay to the Trustee for the benefit of the Bondholders an additional amount equal to 100% of the total amount of interest which became due on the Bonds during the period commencing on the date the Bonds lost their tax-exempt status and ending on the redemption date. This amount shall be deposited by the Trustee into a fund, and any person who was a holder of a Bond during the aforementioned period shall be entitled to an amount equal to 100% of the interest accrued on such Bond during such period. Payment of this amount is not guaranteed by the SBA. There can be no assurance that the Borrower would pay or be able to pay such amount; however the Trustee may, without the consent of the SBA, pursue any available remedy by action, suit or proceeding at law or in equity to insure or realize the payment of such amount.

Notice and Effect of Redemption

Notice of the call for any redemption, identifying the Bonds or portions thereof to be redeemed, shall be given by publishing such notice at least once in financial newspapers of general circulation in the City of Chicago, Illinois, not less than 30 nor more than 60 days prior to the redemption date, and by mailing copies of such notice to the registered owners of any Bonds registered as to principal not less than 30 nor more than 60 days prior to the redemption date and to all holders of unregistered Bonds who have filed their names and addresses with the Trustee for the purpose of receiving such notices. If all the Bonds or portions thereof to be redeemed are at the time registered as to principal, notice by mail shall be sufficient and notice need not be given by publication.

Bonds so called for redemption will cease to bear interest on the specified redemption date and shall no longer be secured by the Indenture, provided funds for such redemption are on deposit at that time with the Trustee.

SUMMARY OF THE PROMISSORY NOTES

The Promissory Note will be executed by the Borrower and delivered to the Authority (and assigned by the Authority to the Trustee) in the aggregate principal amount of its loan. The Promissory Notes mature in 240 substantially level monthly installments of principal and interest payable on October 1, 1980, and on the first day of each month thereafter through and including September 1, 2000. Each particular monthly installment shall be the sum of (i) one-twelfth(1/12th) of the bond principal becoming due on the next following Bond principal maturity or sinking fund redemption payment date, and (ii) one-sixth (1/6th) of the Bond interest becoming due on the next following Bond interest payment date. The monthly installments are in aggregate sufficient to provide for the payment of principal and interest on the Bonds when due.

To facilitate prompt payment of the Bonds, the Loan Agreement requires the Borrower to make all payments of principal of, premium, if any, and interest on the Promissory Note directly to the Trustee in federal or other immediately available funds. Monthly installments on the Promissory Note which are due on Bond principal or interest payment dates are required to be made at least two business days in advance of such due dates.

SUMMARY OF THE LOAN AGREEMENTS

Provision for Revenues to Pay the Bonds

The Borrower unconditionally agrees to make payments to the Trustee (for the account of the Authority) in lawful money of the United States of America, and in such amounts and at such times (if not sooner required under the terms of the Loan Agreement) as shall be necessary to enable the Trustee to make full and prompt payment when due (whether at stated maturity, upon call for redemption prior to stated maturity, or upon acceleration of stated maturity), of the principal of, premium, if any, and interest on all Bonds issued and outstanding under the Indenture. The Loan Agreement provides that the obligation of the Borrower to make such payments shall be absolute and unconditional and shall not be subject to diminution by set off, counterclaim, abatement or otherwise.

Covenants of the Borrower Relating to the Project

The Borrower makes certain covenants with the Authority concerning payment of taxes, licenses and utilities charges; completion, maintenance, insurance and operation of the Project; and certain other matters regarding the character and continued operation of the Project.

Maintenance of Corporate Existence

The Borrower agrees that it will maintain its corporate existence and will not dissolve or otherwise dispose of all or substantially all of its assets and will not consolidate with or merge into another corporation or permit one or more other corporations to consolidate with or merge into it, except that with the consent of the SBA the Borrower may, without violating the foregoing, consolidate with or merge into another corporation, or permit one or more other corporations to consolidate with or merge into it, or transfer all or substantially all of its assets to another such corporation (and thereafter dissolve or not dissolve as the Borrower may elect) if the corporation surviving such merger or resulting from such consolidation, or the corporation to which all or substantially all of the assets of the Borrower are transferred, as the case may be: (i) has a net worth immediately after such action not less than that of the Borrower immediately prior to such action, (ii) is a corporation organized under the laws of one of the States of the United States of America, and (iii) expressly assumes in writing all of the obligations of the Borrower contained in the Loan Agreement and the Promissory Note.

Assignment

The Loan Agreement may be assigned, in whole or in part, by the Borrower without obtaining the consent of either the Authority or the Trustee provided that (a) no such assignment shall relieve the Borrower from liability for any of its obligations under the Loan Agreement or the Promissory Note in the event that the assignee does not perform, (b) the assignee shall assume the obligations of the Borrower under the Loan Agreement and the Promissory Note to the extent of the interest assigned, and (c) the Borrower shall furnish or cause to be furnished to the Authority and the Trustee a true and complete copy of each such assignment or assumption of obligations, as the case may be. No such assignment shall be made without the prior written consent of the SBA, which consent shall state that the SBA Guaranty will remain in effect after such transaction.

Events of Default; Remedies

Occurrence of any one or more of the following constitutes an "Event of Default" under the Loan Agreement:

(a) Default in the due and punctual payment of the principal of and interest on the Promissory Note;

(b) The dissolution or liquidation of the Borrower unless such dissolution or liquidation is permitted in the circumstances described above under "Maintenance of Corporate Existence";

(c) The Borrower shall: (i) become insolvent; or (ii) be unable, or admit in writing its inability, to pay its debts as they mature; or (iii) make a general assignment for the benefit of creditors or to an agent authorized to liquidate any substantial amount of its property; or (iv) become the subject of an "order for relief" within the meaning of the United States Bankruptcy Code; or (v) file a petition, or an answer to a creditor's petition (admitting the material allegations thereof), for liquidation, reorganization or to effect a plan or other arrangement with creditors; or (vi) apply to a court for the appointment of a receiver for any of its assets; or (vii) have a receiver appointed for any of its assets (with or without the consent of the Borrower) and such receiver shall not be discharged within 60 days after his appointment; or (viii) otherwise become the subject of any insolvency proceedings;

(d) Default in the performance or observance of any other of the covenants, agreements or conditions on the part of the Borrower in the Loan Agreement or in the Promissory Note contained and the continuance thereof for a period of 30 days after receipt by the Borrower of written notice specifying such default and requesting that it be corrected.

Upon the happening of an event of default, the Trustee as assignee of the Authority, may declare the Promissory Note to be immediately due and payable, whereupon the same shall become immediately due and payable. This remedy may not be exercised by the Trustee unless approved by the SBA, so long as the SBA is not in default under the SBA Guaranty; and so long as no such default by the SBA exists, the SBA may

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require the Trustee to exercise such remedy. The Authority, or the Trustee as assignee of the Authority, may, on behalf of the SBA as subrogee, take any action at law or in equity as may appear necessary or desirable to collect payments of the principal of and interest on the Promissory Note then due.

Provided that SBA has made an affirmative determination during the processing of the Borrower's application that losses shall be mitigated, upon occurrence of an event of default described in clause (a) above, the Trustee, as a condition precedent to enforcing any claim under the SBA Guaranty, is required to utilize the entire period for which there are funds available in the Escrow Fund for payment of the principal and interest due and payable on the Promissory Note in reasonable diligent efforts to eliminate or minimize losses. No claim may be made or paid under the SBA Guaranty until such Escrow Fund has been exhausted. To the extent that SBA is not then in default on the SBA Guaranty, the remedies set forth in the Loan Agreement will not be exercised without SBA's prior written approval.

Amendments to the Promissory Note and Loan Agreement

The Authority and the Trustee agree not to consent to any amendment, change or modification of the Promissory Note or the Loan Agreement without the giving of notice to and the written approval or consent of the holders of not less than 66⅔% in aggregate principal amount of the Bonds at the time outstanding; except that the Authority and the Trustee may, without the consent of or notice to the Bondholders, consent to any amendment, change or modification of the Promissory Note or the Loan Agreement(i) for the purpose of curing any ambiguity or formal defect or omission, (ii) in connection with the Project so as more precisely to identify the same, (iii) to add new or additional collateral for the performance of the Borrower's obligations thereunder, or (iv) in connection with any other change therein which, in the judgment of the Trustee, is not to the prejudice of the Trustee or the holders of the Bonds. The prior written consent of the SBA is required for any amendment to the Promissory Note or the Loan Agreement.

Special Covenants Regarding Tax Exemption

In the Loan Agreement the Borrower and the Authority make certain agreements and covenants with respect to the exemption from Federal income taxation of interest on the American Fly Ash Bonds.

In the American Fly Ash Loan Agreement certain additional covenants and agreements are set forth. Among other things, the Authority agrees to elect to have the provisions of Section 103(b)(6)(D) of the Internal Revenue Code of 1954, as amended (the "Code") apply to the American Fly Ash Bonds, and American Fly Ash Company agrees to furnish to the Authority the information necessary for the Authority to make such election.

Among other things, American Fly Ash Company agrees that it will file with the Internal Revenue Service all supplemental statements required by Section 1.103-10(b) of the regulations promulgated under the Code. American Fly Ash Company agrees to file at the same time with the Trustee each such supplemental statement, together with a certificate of an independent certified public accountant confirming the accuracy of such statement and the aggregate amount of capital expenditures required to be taken into account under Section 103(b)(6)(D) of the Code during the period covered by such statement.

SUMMARY OF THE INDENTURES

Bond Fund

The Authority has created and ordered established with the Trustee a trust fund designated as the "Bond Fund". There shall be deposited in the Bond Fund the accrued interest received upon the sale of the Bonds and all amounts paid by the Borrower in discharge of its obligation under the Promissory Note. Additionally, there shall be deposited in the Bond Fund, as and when received, any payments made on the SBA Guaranty and any other moneys when accompanied by directions from the Authority or the Borrower or where provided in the Loan Agreement that such moneys are to be paid into the Bond Fund.

Except as expressly provided in the Indenture, moneys in the Bond Fund shall be used solely for the payment of the principal of, premium, if any, and interest on the Bonds when due. Moneys in the Bond Fund are pledged to secure the Bonds.

Escrow Fund

The Authority has created and ordered established with the Trustee a trust fund designated as the "Escrow Fund". There will be deposited in the Escrow Fund from the proceeds of the sale of the Bonds an amount equal to one-fourth of the average annual debt service requirement on the Bonds as indicated herein under the caption "USE OF PROCEEDS". The Trustee shall use the Escrow Fund to make payments of principal and interest on the Promissory Note in the event the Borrower defaults in making such payments. No payments will be made by the SBA under the SBA Guaranty until the Escrow Fund is exhausted.

Expense Fund

The Authority has created and ordered established with the Trustee a trust fund designated as the "Expense Fund". There will be deposited in the Expense Fund from the proceeds of the sale of the Bonds an amount equal to those estimated Bond issuance costs as indicated herein under the caption "USE OF PROCEEDS". The Trustee shall disburse the Expense Fund to pay the SBA Guarantee Fee, the SBA Processing Fee, the Underwriter's management fee, the Trustee's acceptance fee, legal fees, printing costs and other Bond issuance expenses.

Construction Fund

The Authority has created and ordered established with the Trustee a trust fund designated as the "Construction Fund" which shall be used to pay costs of providing the Project. It shall also be used to pay Bond issuance expenses in the event the balance in the Expense Fund is insufficient therefor. There will be deposited in the Construction Fund from the proceeds of the sale of the Bonds an amount equal to the estimated Project costs as indicated herein under the caption "USE OF PROCEEDS".

The Trustee is authorized to make payments to the Borrower from the Construction Fund upon receipt from the Borrower of a requisition signed by an authorized representative of the Borrower setting forth certain information and containing a statement that the payment is a proper charge against the Construction Fund. Any moneys remaining in the Construction Fund after certification of Project completion shall, at the direction of the Borrower, be used for: (i) purchase of Bonds in the open market for cancellation in accordance with the Indenture; (ii) payment of Bonds called for redemption; (iii) payment of the costs of additional pollution control facilities if accompanied with an opinion of nationally recognized bond counsel satisfactory to the Trustee to the effect that such application will not cause the Bonds to lose their tax-exempt status; (iv) transfer into the Bond Fund to constitute a credit against the next ensuing principal payment on the Bonds; or (v) any combination of the foregoing.

Investment of Moneys

Moneys, if any, in the Bond Fund, the Expense Fund and the Construction Fund shall, upon direction of the Borrower, be invested by the Trustee in one or more of the following types of investments: (i) bonds, notes, certificates of indebtedness, Treasury bills or other securities constituting direct obligations of, or obligations unconditionally guaranteed by, the United States of America, (ii) certificates of deposit or time deposits constituting direct obligations of any State Bank or National Bank as defined by the Illinois Banking Act, as amended, provided, that investments may be made only in those certificates of deposit or time deposits which are insured by the Federal Deposit Insurance Corporation, if then in existence (including the Trustee and any affiliate of the Trustee), which has capital, surplus and undivided profits in excess of $500,000, but in no event shall the amount invested at any one time in time deposits and certificates of deposit issued by any one bank equal or exceed 20% of the capital, surplus and undivided profits of such bank, and (iii) short term discount obligations of the Federal National Mortgage Association.

Moneys in the Escrow Fund shall be invested in one or more of the investments described in clauses (i) or (ii) above and shall have a maturity of not more than 30 days. The SBA may direct the investment of the Escrow Fund.

Any such investment shall be deemed at all times to be a part of the fund in which such moneys were originally held and the interest accruing thereon and any profit realized therefrom shall be credited to such fund, and any loss resulting therefrom shall be charged to such fund and paid by the Borrower.

The Borrower agrees in the Loan Agreement that it will not authorize any investment which would cause the Bonds to be "arbitrage bonds" within the meaning of Section 103(c) of the Internal Revenue Code of 1954, as amended, or any regulations issued or to be issued thereunder.

Defeasance

The Authority may pay and discharge the entire indebtedness on all Bonds outstanding in any one or more of the following ways:

(a) by paying or causing to be paid the principal of (including premium, if any) and interest on all Bonds outstanding, as and when the same become due and payable;

(b) by depositing with the Trustee, in trust, at or before maturity, money in an amount sufficient to pay or redeem (when redeemable) all Bonds outstanding;

(c) by delivering to the Trustee, canceled or for cancellation, all Bonds outstanding, together with the unpaid coupons; or

(d) by depositing with the Trustee, in trust, investments (but only to the extent that the full faith and credit of the United States of America are pledged to the timely payment thereof), the principal of and interest on which, when due, will provide moneys which, together with any cash deposited with the Trustee, shall be sufficient to pay when due, the principal and interest due and to become due on the Bonds at or prior to the redemption date or maturity date thereof, as the case may be.

Events of Default; Remedies

It shall be an "Event of Default" under the Indenture if any of the following shall occur: (i) default in the due and punctual payment of any interest on any Bond; (ii) default in the due and punctual payment of the principal of or redemption premium, if any, on any Bonds, whether at stated maturity thereof, or at the date for redemption thereof, or upon the maturity thereof by declaration, acceleration or otherwise; (iii) default in the performance or observance of any other of the covenants, agreements or conditions on the part of the Authority in the Indenture or in the Bonds contained and the continuance thereof for a period of 30 days after receipt of the notice described below; or (iv) default on the part of the Borrower under the Loan Agreement or the Promissory Note and the continuance thereof beyond the period of grace, if any, specified in the Loan Agreement.

No default specified in (iii) above shall constitute an Event of Default unless notice of such default by registered or certified mail shall be given by the Trustee, or by the holders of not less than 10% in aggregate principal amount of Bonds then outstanding, to the Authority and the borrower, and the Borrower or the Authority shall not have corrected such default within 30 days after receipt of such notice.

Except as provided in the Indenture, no holder of any Bond or coupon shall have any right to institute any suit, action or proceeding at law or in equity for the enforcement of the Indenture or the exercise of any remedy thereunder.

Upon the occurrence of an Event of Default, the Trustee may, and upon the written request of the holders of not less than 25% in aggregate principal amount of the Bonds then outstanding shall, by notice in writing, declare the principal of all Bonds then outstanding and the interest accrued thereon, to be immediately due and payable.

Upon the occurrence of an Event of Default, the Trustee may proceed to pursue any available remedy by suit at law or in equity to enforce the payment of the principal of and interest and redemption premium, if any, on the Bonds then outstanding, including the enforcement (subject to the consent or direction of the SBA) of any and all rights of the Authority under the Loan Agreement. If an Event of Default shall have occurred and be continuing, and if required so to do by the holders of not less than 25% in aggregate principal amount of

Bonds then outstanding, and if adequately indemnified, the Trustee shall be obligated to exercise such one or more of the rights and powers conferred by the Indenture as the Trustee, being advised by counsel, shall deem most expedient in the interest of the Bondholders. Anything in the Indenture notwithstanding, the holders of a majority in aggregate principal amount of Bonds then outstanding shall have the right, at any time, by an instrument or instruments in writing executed and delivered to the Trustee, to direct the method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, or for the appointment of a receiver or any other proceedings under the Indenture; provided, that such direction shall not be otherwise than in accordance with the provisions of law and of the Indenture.

Supplemental Indentures

The Authority and the Trustee may without the consent of, or notice to, any of the Bondholders, enter into an indenture or indentures supplemental to the Indenture as shall not be inconsistent with the terms and provisions thereof: (i) to cure any ambiguity or formal defect or omission in the Indenture or in any supplemental indenture; (ii) to grant to or confer upon the Trustee for the benefit of the Bondholders any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Bondholders or the Trustee; (iii) to subject to the lien and pledge of the Indenture additional revenues, properties or collateral; (iv) to evidence the appointment of a separate trustee or a co-trustee or the succession of a new trustee; (v) to modify, eliminate and/or add to the provisions of the Indenture to such extent as shall be necessary to effect the qualification of the Indenture under the Trust Indenture Act of 1939, as then amended; and (vi) to the extent necessary with respect to any properties forming a part of the Project so as to more precisely identify the same.

Exclusive of supplemental indentures above described, the holders of not less than 66⅔% in aggregate principal amount of the Bonds then outstanding shall have the right from time to time, to consent to and approve the execution by the Authority and the Trustee of such other indenture or indentures supplemental thereto as shall be deemed necessary and desirable by the Authority for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Indenture or in any supplemental indenture; provided, however, that nothing shall permit, or be construed as permitting, without the consent of the holders of all the Bonds then outstanding: (i) an extension of the maturity of the principal of or the interest on any Bonds, or (ii) a reduction in the principal amount of any Bonds or the rate of interest thereon, or (iii) a privilege or priority of any Bond over any other Bond or (iv) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental indenture.

In no event may the Indenture be supplemented or modified in a manner which adversely affects the rights of the Borrower under the Loan Agreement unless the Borrower consents thereto or fails to object within the time specified in the Indenture. In addition to the consents hereinabove described, the prior written consent of the SBA is required for any amendment to the Indenture.

TAX EXEMPTION

Federal Income Tax Exemption

Generally, interest on obligations of a state or a political subdivision of a state is exempt from Federal income taxation. Section 103(b) of the Internal Revenue Code (the "Code"), however, provides that interest on any such obligation which is an "industrial development bond" shall not be exempt. An exception to that provision (applicable to the American Fly Ash Bonds) is created by Section 103(b)(6)(D) of the Code for industrial development bonds issued as a part of an issue the aggregate authorized face amount of which, plus certain prior outstanding "exempt small issues", if any, together with certain defined capital expenditures paid or incurred during the six-year period beginning three years before the date of the issue and ending three years after such date is $10,000,000 or less. Another exception to that provision (which is applicable to the Del Mar Bonds) is created by Section 103(b)(6)(A) of the Code for issues of industrial development bonds issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less. In addition, the tax exemption with respect to the Bonds is not applicable to the interest on any Bond for any period during which such Bond is held by a person who is a substantial user of the Project or any person considered to be related to such person (within the meaning of Section 103(b) of the Code).

In the opinion of Foley, Lardner, Hollabaugh & Jacobs, Washington, D.C., Bond Counsel, the receipt of interest on the Bonds is exempt from income taxation by the United States of America under present statutes, regulations, court decisions and rulings, except as described below under the caption "Possible Loss of Federal Tax Exemption" and except that such exemption may possibly be lost for interest on any Bond for any period during which the Bond is held by a person who is a "substantial user" of the Project or a "related person" within the meaning of Section 103(b)(9) of the Internal Revenue Code of 1954, as amended. No opinion is expressed with respect to the taxability of interest on a Bond for any period during which the Bond is so held by such substantial user or related person.

Possible Loss of Federal Tax Exemption

The Federal tax exemption applicable to the American Fly Ash Bonds may be lost if certain defined capital expenditures paid or incurred during the period beginning on the date of the issue and ending three years after such date are of such amount that the aggregate authorized face amount of the issue, plus certain prior outstanding "exempt small issues", if any, together with certain defined capital expenditures paid or incurred during the six-year period beginning three years before the date of the issue and ending three years after such date is more than $10,000,000.

If such event is a result of the failure by American Fly Ash Company to observe or perform any covenant or agreement contained in the Loan Agreement or any act, omission or event whatsoever within the control of American Fly Ash Company, a Tax Violation would be deemed to have occurred. Accordingly, the American Fly Ash Bonds would be called for mandatory redemption and American Fly Ash Company would be obligated to make additional payments, as described herein under the caption "Mandatory Redemption in the Event of a Tax Violation".

LEGAL MATTERS

Legal matters incident to validity of the authorization and issuance of the Bonds are subject to the unqualified approval of legality by Foley, Lardner, Hollabaugh & Jacobs, Washington, D.C., Bond Counsel, whose approving opinion will be delivered with or printed on the Bonds. Foley, Lardner, Hollabaugh & Jacobs are outside general counsel to the Underwriter and will also be passing on certain matters for the Underwriter; however, Foley, Lardner, Hollabaugh & Jacobs have not been retained to pass upon the adequacy, accuracy or completeness of the information contained in Appendix A to this Official Statement, and consequently have expressed no opinion thereon.

Certain legal matters will be passed upon for the Authority by the law firm of Hopkins, Sutter, Mulroy, Davis & Cromartie, Chicago, Illinois.

Certain legal matters will be passed upon for the American Fly Ash Company by the law firm of Chapman & Cutler, Chicago, Illinois.

Certain legal matters will be passed upon for Del Mar Plating & Anodizing Co. by the law firm of Wahler & Pecyna, Chicago, Illinois.

UNDERWRITING

First Wisconsin National Bank of Milwaukee (the "Underwriter") has agreed, subject to the terms of a Bond Purchase Agreement, to purchase from the Authority all of the Bonds offered hereby. The aggregate purchase price payable by the Underwriter is 98.5% of the principal amount, plus accrued interest from September 1, 1980, to the date of delivery. The Bonds are being offered for sale at the initial price stated on the cover of this Official Statement. Concessions from the initial price may be allowed to selected dealers and special purchasers. The initial offering price is subject to change after the date hereof. Each Borrower has agreed to indemnify the Underwriter and the Authority against certain civil liabilities, including liabilities under the Securities Act of 1933, as amended.

DISCUSSION OF BOND RATINGS

Moody's Investors Services, Inc. has assigned an investment rating of "Aaa" to the Bonds. No application was made to any other rating agency for the purpose of obtaining an additional rating thereon. Any explanation as to the significance of the rating assigned may only be obtained from Moody's Investors Services, Inc.

The Borrower furnished to Moody's Investors Services, Inc. information and materials, some of which have not been included in this Official Statement. Generally, rating agencies base their ratings on such information and materials and investigations, studies, assumptions furnished to, obtained and made by the rating agencies. There is no assurance that the rating assigned will remain for any given period of time or that it may not be changed or withdrawn entirely by the rating agency, if, in its judgment, circumstances so warrant. Any downward change in or withdrawal of the rating may have an adverse effect on the market price of the Bonds.

MISCELLANEOUS

The foregoing summaries do not purport to be complete and are expressly made subject to the exact provisions of the complete documents. For details of all terms and conditions, prospective purchasers are referred to the Promissory Notes, the Loan Agreements and the Indentures, copies of which may be obtained from the Underwriter until the closing of the bond issue and thereafter from the Trustee. The Appendices attached hereto are a part of this Official Statement.

The execution of this Official Statement has been duly authorized by the Authority.

ILLINOIS ENVIRONMENTAL FACILITIES
FINANCING AUTHORITY

By /s/ NICOLE WILLIAMS FOSTER
Its Chairman

APPENDIX A

DESCRIPTION OF THE BORROWERS AND THE PROJECTS

American Fly Ash Company

American Fly Ash Company (the "Borrower") is an Illinois corporation located in Cook County, Illinois, and is primarily engaged in road base production and sale, and by-product disposal, and sale of fly ash as a component of concrete.

The Borrower began operation in 1946 and was first incorporated in the State of Illinois in 1952. The Borrower employs approximately 40 persons.

The Project is designed to enable the Borrower to comply with certain solid waste disposal regulations of the Illinois Environmental Protection Agency. It involves the construction of a coal ash recycling/disposal facility, including excavation, monitoring wells, fly ash storage silos, compressors, stackers and conveyors.

The estimated cost of the Project (excluding bond issuance costs) is $2,100,000.

Del Mar Plating & Anodizing Co.

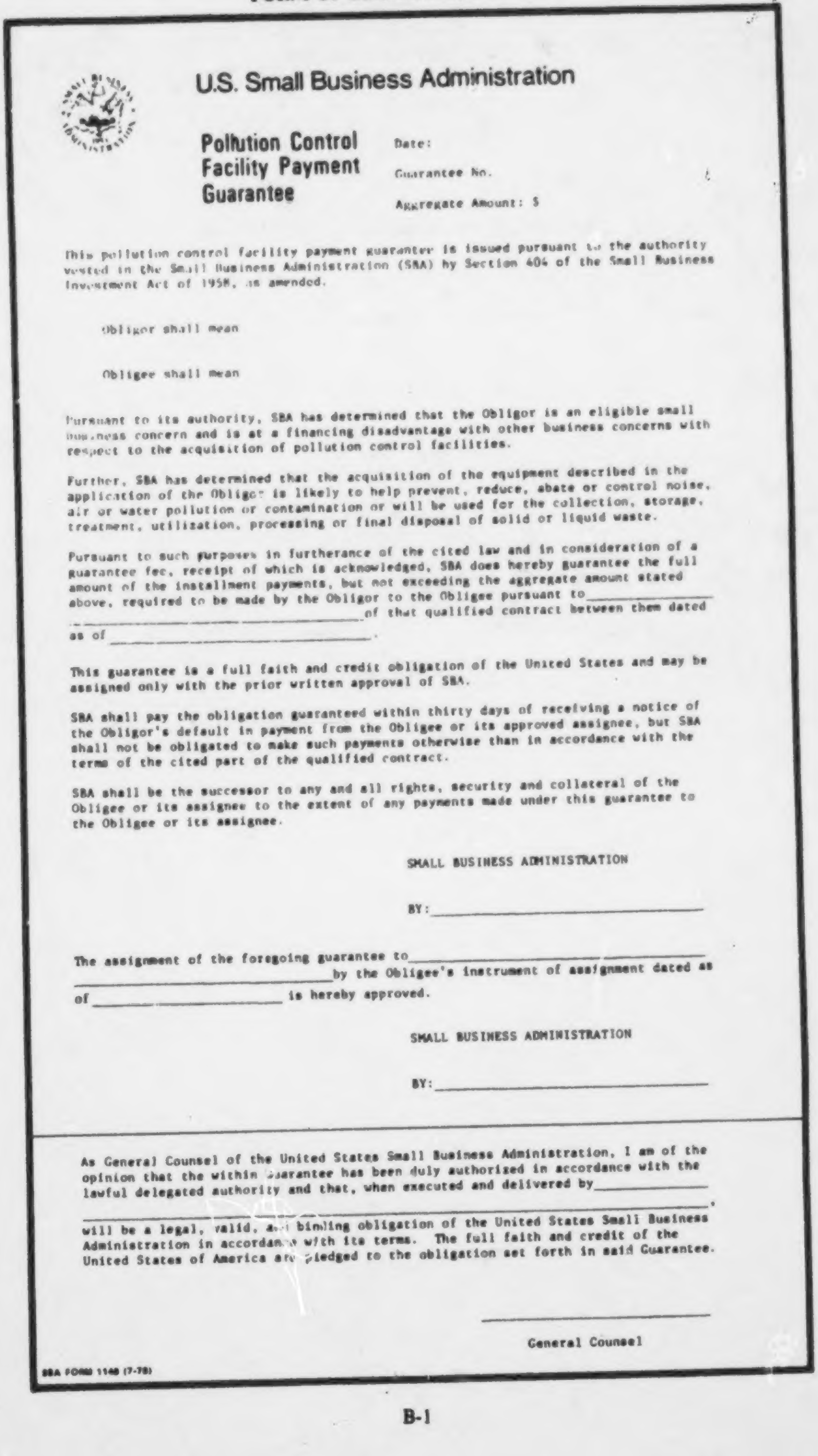
Del Mar Plating & Anodizing Co. (the "Borrower") is an Illinois corporation located in the Village of Franklin Park, Illinois, and is primarily engaged in metal finishing.

The Borrower was incorporated in the State of Illinois in 1961. The Borrower employs approximately 18 persons.

The Project is designed to enable the Borrower to comply with certain water quality regulations of the Metropolitan Sanitary District of Greater Chicago. The Project will allow the Borrower to recover used chemicals from plating wastes, recycle wastewater, and dispose of sludge. It includes the installation of a rinse-loop system.

The estimated cost of the Project (excluding bond issuance costs) is $138,069.

APPENDIX B
FORM OF SBA GUARANTY



U.S. Small Business Administration

Pollution Control Facility Payment Guarantee

Date:

Guarantee No.

Aggregate Amount: $

This pollution control facility payment guarantee is issued pursuant to the authority vested in the Small Business Administration (SBA) by Section 404 of the Small Business Investment Act of 1958, as amended.

Obligor shall mean

Obligee shall mean

Pursuant to its authority, SBA has determined that the Obligor is an eligible small business concern and is at a financing disadvantage with other business concerns with respect to the acquisition of pollution control facilities.

Further, SBA has determined that the acquisition of the equipment described in the application of the Obligor is likely to help prevent, reduce, abate or control noise, air or water pollution or contamination or will be used for the collection, storage, treatment, utilization, processing or final disposal of solid or liquid waste.

Pursuant to such purposes in furtherance of the cited law and in consideration of a guarantee fee, receipt of which is acknowledged, SBA does hereby guarantee the full amount of the installment payments, but not exceeding the aggregate amount stated above, required to be made by the Obligor to the Obligee pursuant to ______________ ______________________________ of that qualified contract between them dated as of ______________________.

This guarantee is a full faith and credit obligation of the United States and may be assigned only with the prior written approval of SBA.

SBA shall pay the obligation guaranteed within thirty days of receiving a notice of the Obligor's default in payment from the Obligee or its approved assignee, but SBA shall not be obligated to make such payments otherwise than in accordance with the terms of the cited part of the qualified contract.

SBA shall be the successor to any and all rights, security and collateral of the Obligee or its assignee to the extent of any payments made under this guarantee to the Obligee or its assignee.

SMALL BUSINESS ADMINISTRATION

BY: ______________________________

The assignment of the foregoing guarantee to ______________________________ ______________________________ by the Obligee's instrument of assignment dated as of ______________________ is hereby approved.

SMALL BUSINESS ADMINISTRATION

BY: ______________________________

As General Counsel of the United States Small Business Administration, I am of the opinion that the within Guarantee has been duly authorized in accordance with the lawful delegated authority and that, when executed and delivered by ______________ ______________________________, will be a legal, valid, and binding obligation of the United States Small Business Administration in accordance with its terms. The full faith and credit of the United States of America are pledged to the obligation set forth in said Guarantee.

____

General Counsel

SBA FORM 1148 (7-78)

INDUSTRIAL DEVELOPMENT BONDS AND THEIR IMPORTANCE TO ALASKA AND THE NATION

Testimony of Thomas K. Williams,
Commissioner of Revenue of the State of Alaska and
Vice-Chairman of the Alaska Industrial Development Authority

Presented to

The Urban and Rural Economic Development Subcommittee
of the Committee on Small Business
United States Senate

October 5, 1981

Mr. Chairman and Honorable Members of the Committee:

My name is Thomas K. Williams , and I am the Commissioner of Revenue of the State of Alaska and the Vice Chairman of the Alaska Industrial Development Authority (AIDA). My purpose in testifying before you today is to explain how AIDA works, what AIDA means for Alaska's future, and why retricitng or ending the availability of tax-exempt, industrial-development revenue bonds (IDBs) would hamper and frustrate the AIDA program.

An instrumentality of the State of Alaska, but with a separate legal existence, AIDA serves statewide as a source of capitol for economic development through the issuance of IDBs. Under the Internal Revnue Code three categories of developmental projects qualify for tax-exempt bonding -- certain exempt facilities, such as docks and pollution control equipment, which qualify regardless how much they cost, capital projects of any other kind which cost $10,000,000 or less, but only if the owner of the project does not have a total capital investment (including the project) exceeding $10,000,000 in the same political subdivision as the project at any time during the three years before and the three years after the bonds are issues; and capital projects for which the amount of bonds being issued does not exceed $1,000,000.

Until this year, AIDA only issued bonds on a "stand alone" basis for longer projects which either qualified as exempt facilities or staisfied the $10,000,000 limitation. However, last year the Alaska legislature amended AIDA's powers to aloow the combined issuance of separate series of bonds for small projects of $1,000,000 or less in order to extend to small businessmen the opportunity to obtain tax-exempt financing which larger businesses enjoy. Because of the practical impossibility of getting a bond rating for each small business and winning market acceptance of bonds for them on a project-by-project basis, these bonds are issued under the "umbrella" of a pledge of AIDA's own general obligation and/or the moral obligation of the State of Alaska. This pledge provides a common source of security for AIDA's umbrella bonds in addition to the security provided by the project owner, and as a practical matter, it is chiefly on the strength of AIDA's pledge that these bonds are rated and accepted in the marketplace.

This past June AIDA had its first sale of umbrella bonds, totalling more than $17,000,000 for over 50 different projects. A few were for the full $1,000,000 but you can tell from the average of $340,000 per project that most were for significantly less -- one was for only $20,000. The types of projects ranged from commercial fishing vessels for Alaska's newly developing bottomfish industry, to computers, construction equipment and warehousing.

Some of these projects might have been able to afford conventional financing at today's sky-high iterest rates, but others could not. For them the AIDA umbrella program made the critical difference.

The importance to Alaska of allowing AIDA to continue to make this difference must not be underestimated. Right now Alaska and her people are enjoying a period of moderate prosperity, thanks to a freak of geology known as the Prudhoe Bay oil field. But one percent of that enormous resource is depleted and forever gone every 60 days. Hence, it is imperative for Alaska's future well-being that we diversify our economy into other, more sustainable activities while we can. AIDA's role in facilitating that diversification is obvious.

Recently, IDBs have come under atatck. Too many McDonald's and K-Mart stores are being built with tax-exempt financing, the critics assert. Some point to certain political subdivisions that are issuing IDBs for projects outside their jurisdictional boundaries, apparently with the sole objective of getting a fee for issuing them. In reaction to these and other criticisms, the IRS has issued Ruling 81-216. Legislation is being disucssed here in Congress that would sharply curtail the issuance of IDBs, if not end it altogether.

Before commenting on IDBs generally, let me briefly address Ruling 81-216. This is the worst idea of the IRS in a long time. The ruling doesn't end IDBs for McDonalds', K-Mart or anyone else. It doesn't even put an end to combined issues like AIDA's umbrella bond program. What it does do is to make it more expensive to issue umbrella bonds by limiting the amount of them that are issued at any one time -- a smaller combined issue to bear the relatively fixed costs of issuance, those issuance costs become proportionally greater in relation to each project. This works to the advantage of the giant firms since they can either absorb the cost without unduly affecting overall profits or they can pass the cost on to the consumer through small price increases, but the small businessman generally can aford to do neither. Thus, the ruling works exactly backwards from what it presumably was intended to do.

Returning now to the subject of IDBs in general, I acknowledge that some abuses have developed that should be corrected, particularly regarding local bonding for projects outside the locality's jurisdiction. However, I do not believe that IDBs should be stopped nor that Congress should limit at this time the purposes to which they may be applied.

Today's high interest rates severly impede business growth and development in America. These rates result from federal overspending and federal monetary policies. Wisely, the federal government is returning responsibility back to the states in many areas. As it does so, it must allow the states full freedom to cope with these regained responsibilities, including the further development of business, which will, after all, bear the burden of the states' expanded roles. Thus it would be particularly inappropriate now to restrict or take away from the states so valuable a tool as IDBs. I know it would be grave for Alaska, and I submit it would ill serve the nation as a whole.

Thank you very much for this opportunity to make known to you the views of Alaska and the Alaska Industrial Development Authority regarding this important subject.

TESTIMONY OF
ROBERT E. PATTERSON
EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY
BEFORE THE
SENATE SMALL BUSINESS SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT

October 5, 1981 - Mr. Chairman and honorable members of the subcommittee: Everyone seems to agree that the United States should direct its economic resources toward the goals of higher productivity and more jobs. An essential part of this effort has to be aid to smaller innovative companies and distressed areas.

I can speak from the perspective of five years in state government devoted to restoring the economic vitality of an old Northeastern state where the country's industrial revolution began and which today comprises about half the New England economy. Though we have a long way to go to restore our region to prosperity, Massachusetts' recovery from a 12% unemployment rate and countless vacant mill buildings in our historic cities has dramatically exceeded everyone's expectations back in 1975. Government incentives to induce productive private investment have played an extremely important role in this recovery despite the highest interest rates in our history.

Critical federal programs have included the Urban Development Action Grant and Community Development Block Grants administered by HUD, and incentives provided through the Small Business Administration and the Economic Development Administration. All these programs and agencies have experienced major funding reductions in the 1982 budget that went into effect last Thursday. As you well know, we probably face even more budget cuts in the future.

With interest rates still hovering at 20 percent and federal assistance to small business and urban development declining, there remains one important incentive available to state and local governments to assist growing smaller companies and distressed areas. Industrial development bonds still offer smaller companies their only real opportunity to borrow at affordable interest rates for productive investment in plant and equipment. And if responsibly targeted these bonds can provide distressed areas the most powerful development incentive likely to be around for the foreseeable future.

Now industrial revenue bonds are under major attack. The Treasury, which to my knowledge has been opposed to all tax-exempt financing with varying intensity since the introduction of the graduated income tax made that exemption valuable to state and local governments, has fired the first salvo in this year's attack by springing Revenue Ruling 81-216. This arbitrary ruling was issued without any notice or opportunity for public comment. It represents a dramatic reversal of prior IRS policy. In fact, it expressly revokes three prior rulings which have been relied on by many states in their programs to assist farmers and small business.

Underneath the technicalities of Rev. Ruling 81-216 lies a very simple practical fact. This ruling will effectively close off reasonably priced credit for growing small businessmen and farmers. It will reek havoc with the Small Business Administration's guaranteed bond program for pollution control financing, which we have been using in Massachusetts and which was just increased by Congress. And most importantly of all, it will have unbelievably unfair competitive consequences for smaller business via-a-vis their larger competitors.

I will come back to Rev. Ruling 81-216 in a moment, but first I would like to offer a few observations on industrial development bonds in general which may be timely as President Reagan has indicated that the Treasury will be proposing elimination or severe restrictions on these bonds in the very near future.

IRBs have come in for some very bad publicity recently, starting with the media reports of the Congressional Budget Office's findings and a relatively few sensational abuses. I cannot defend the way all industrial revenue bond programs have been operated throughout the country. My recent article in Commentary magazine, which was inserted in the Congressional Record by Congressman Moakley, argued that changes should be made in industrial development bonds. In my opinion the program must be more effectively targetted towards smaller companies and distressed areas or this powerful incentive will not survive.

It is critical, however, that Congress not throw out the baby with the bath water and that some reasonable discussion take place to preserve what is worthwhile and perhaps essential in the current environment of high interest rates. I would like today to point out how we have used IRBs in Massachusetts, and how important they have been to our smaller companies and distressed areas. In passing, I would also like to point out some facts contained in the CBO's report, facts which have been widely overlooked.

First, CBO found that IRBs, thanks to the $10 million capital expenditure limitation, have been used primarily to finance the growth of smaller companies. CBO found that over 90% of IRB recipients in 1978 and 79 were not listed on any national or regional stock exchange. Furthermore, of some 8,000 small issues in those two years, only 7% went to the top "Fortune 50" non-industrial or the "Fortune 1,000" industrial firms.

In Massachusetts one-half of the industrial companies we have assisted have sales of less than $5 million, and some three-quarters have sales of less than $20 million.

Let me try to give you a better picture of what IRBs have meant to the growth of these company. The average company with sales under $5 million borrowed $655,000 for productive assets. Since almost everything is a question of "compared to what", this new debt has to be compared with a net worth of $500,000, sales of $2 million and net income of $120,000. Considering that these companies also have other major debt, much of it at interest rates floating above the prime rate, these companies were undertaking very major expansions, borrowing over 5 1/2 times their net income and 1 1/3 times their net worth at a time of rising interest rates and widespread economic uncertainty.

There is, of course, continuing debate as to how many companies would have expanded without IRBs. Intuitively you just have to consider the figures I just recited to know that the lower IRB interest rate was important in the decision to invest in long-term productive assets. It is probably impossible, however, to know with certainty precisely what the stimulative effects of IRBs have been.

At the national level, CBO estimated in its report that IRBs will generate over $4 billion in additional gross national product in 1986. CBO's projections show that IRBs in that year will be responsible for additional private wages and salaries totalling $2.25 billion, enough to employ 150,000 people at $15 000 a year! And this stimulative effect, again by CBO's estimates, would cost the federal Treasury (i.e. revenues which the Treasury would have to spend were IRBs to be eliminated) of only $700 million or less than $5,000 per job.

Even these cost figures estimated by CBO may be too high. Further work on this question showing substantially smaller costs to the federal Treasury has been done by Professor Kormendi at the University of Chicago Business School on a project for the Small Business Foundation of America and my agency.

I suggest that $700 million will not prove significant in 1986 in balancing the budget or bringing down interest rates. The elimination of IRBs, however, would have a devastating effect on the expansion of smaller companies until interest rates decline.

At the state level, in Massachusetts we are just completing a survey of those companies which my agency has assisted with tax-exempt financing. Surprisingly, approximately 1/3 of the companies answered even though we made it clear that the survey was completely voluntary. Of those responding fully 93.1% indicated that they would have been forced to alter their investments if IRBs had not been available. One-third of the companies stated that they would not have been able to expand at all without an IRB. Another third said they would have delayed their expansion without IRBs. And one-fifth said that they would have expanded less due to higher interest costs in the absence of IRBs.

Incidentally, these companies responding reported having already added 80% of the new jobs they projected at the time of starting their IRB-assisted project. In total, these projects in Massachusetts will create more than 40,000 additional jobs when completed and in full operation.

Financing of commercial enterprises with tax-exempt bonds nationally has caused, in my opinion, much of the uproar and publicity about "abuses". But we should not lose sight of the fact that, particularly at today's interest rates, the IRB incentive if restricted to distressed areas can be a powerful development tool.

In Massachusetts over the last 2 1/2 years we have assisted 72 commercial urban revitalization developments. Though only 9% of our bonds, these projects represent $150 million of new investment in our older distressed downtowns. Five years ago nearly everyone told me there downtowns would never be revived in a depressed state like Massachusetts. But rather than throw away our heritage, we carved out an excellent incentive program with IRBs for these downtowns which are so important to our past and our future. We added additional state incentives and public investments, and the results have surprised even the most optimistic of us working for city revitalization.

In closing, I think it is important that everyone understand what the true effect of Rev. Ruling 81-216 will be. As Governor King of Massachusetts recently wrote to the President, "This ruling effectively closes off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible....It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral (insurance or bank letter of credit). It is bad enough that these companies must pay higher rates to purchase the collateral they need to buy access to the national debt markets. It is unacceptable, however, that the IRS with Rev. Ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased. "

Under the guise of tax code technicalities, the Treasury is forcing small businesses out of IRBs. The reality of this ruling will be to tell smaller companies that they cannot get financing from the national credit markets. Given today's commercial banks' prime rate and the condition of the thrift industry, plus the fact that approximately 1/2 of the banking assets in Massachusetts are held by thrift institutions, this is tantamount to telling these companies that they can finance their real estate expansions only as tenants of big developers. Being a tenant in a big industrial park is not what most of the small businessmen I have worked with want as part of their business plan for growing, adding jobs, and investing in the future.

Finally, the CBO stated at the end of its summary on IRBs:

> "If the Congress eliminated tax-exemption on small issue IRBs some investments might not move forward. Others might move ahead, but changes in the amount and timing of the investment would result. Smaller firms would be the most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing."

I could not agree more with this prognosis based on my experience over the past few years in Massachusetts. Abolishing IRBs will save little or no tax revenue, and I urge you to restrict the program responsibly and in the process legislatively repeal Rev. Ruling 81-216.

Senator DIXON. Mr. Chairman, Senator Nunn, the ranking member of the full committee, has requested that a statement by Mr. J. David Chestnut, general counsel to the Development Authority of De Kalb County, Ga., and presented to the House Ways and Means Committee on April 9, 1981, be included in today's record.

Senator D'AMATO. Without objection, that is so ordered.

[The material follows:]

TESTIMONY OF J. DAVID CHESNUT TO THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS & MEANS, HOUSE OF REPRESENTATIVES OF THE UNITED STATES

April 9, 1981

Part I	Oral Presentation
Part II	Written Presentation
Appendix A	List of Bond Issues Completed by the Development Authority of DeKalb County
Appendix B	List of Inducement Resolutions adopted by the Development Authority of DeKalb County

J. David Chesnut, Esq.
Chesnut & Livingston, P.C.
6485 Peachtree Industrial Blvd.
Doraville, Georgia 30360
(404)458-7606

General Counsel To:
Development Authority of DeKalb County
6485 Peachtree Industrial Blvd.
Doraville, Georgia 30360
(404)458-7606

PART I

COMMENTS OF J. DAVID CHESNUT BEFORE THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS & MEANS, HOUSE OF REPRESENTATIVES OF THE UNITED STATES

April 9, 1981

My name is David Chesnut and I am the general counsel for the Development Authority of DeKalb County, Georgia which is located in the metropolitan Atlanta area. I appreciate this opportunity to appear before this Subcommittee of Congress in support of retaining and further encouraging industrial revenue bond financing.

The Authority has power to issue industrial revenue bonds in DeKalb County, Georgia. DeKalb County is a microcosm of the rural-suburban-urban blend of our country. Part of our county is actually within the city of Atlanta, part is very prosperous with many new businesses and industrial parks, part is rural, and part, unfortunately, is undeveloped. The Development Authority of DeKalb County, the DeKalb County Government and DeKalb County Chamber of Commerce consider it their obligation to encourage industry to locate where jobs are most needed and often where industry is not intially inclined to locate.

Industrial revenue bonds are an important tool in promoting this economic development by businesses. In our country there are many businesses which would not otherwise make capital investment with the extremely high interest rates now in existence. The availability of tax-exempt financing makes projects feasible which would otherwise not be so. It has been our experience that the use of industrial revenue bonds has resulted in an increase in overall capital formation and employment. They are very important to the people who live in DeKalb County, Georgia.

The use of industrial revenue bonds is the basis for expansion of the tax bases-- individual and corporate income taxes for the state government and federal government and increased ad valorem property taxes for DeKalb County. This has not been considered in the Congressional Budget Office Report. An example of how this yields the United States Government a $276,500 profit each year on a tax exempt issue of $1,500,000, is cited in the written material.

This problem which you are considering reminds me of a childhood event relating to my grandfather's mule. At that time I wanted to be a vet and was going to practice on Papa's mule. He came up as I was fixing to administer 5 gallons of mineral oil to old "Jaybird". Papa quickly admonished me "If the mule ain't sick don't treat it. If it is sick and a quart of oil will cure it don't give it too much and kill it."

Now I perhaps have a very simplistic economic view of our system, but it is my belief that what is hurting this country most is loss of time of people who want to work. In DeKalb County industrial revenue bonds are like Papa's mule. They are extremely productive and working well and have allowed many small businesses to give individual employees this opportunity and the result has been more material goods produced and time not lost forever. If we look at our total gross national product it is merely the sum of time profitably spent, and in my mind nothing which encourages this should ever be considered for elimination. Congress should take the same approach as Papa and not treat the mule if it isn't sick.

We are very proud of what we have been able to do to create an environment in which these businesses can continue in business and prosper and in the aggregate we believe our 34 bond issues for $53,000,000 have created more than 1,886 new jobs.

Another instance with the mule occurred when the mule got in the corn patch on several occasions. Grandmother suggested that the corn patch be moved to another field; Papa replied, "No, we have just got to build a better fence".

Likewise, it is our understanding that the main objection to industrial revenue bonds is that they are being used with increasing frequency to finance a wide range of facilities that are not industrial in nature and that industrial revenue bonds in effect provide a federal tax subsidy of a kind which cannot be controlled by the federal government. If others are abusing the use of tax, then like Papa said build a better fence; don't kill the mule or hire someone to watch it all day. Our Authority and the bond counsel with whom we have worked have exercised an extremely high standard in evaluating projects and from the list of projects attached it can be seen that none of these are abuses. Lack of federal control should be considered to be an advantage. There is no way that state development officials much less officials on the federal level can evaluate and react quickly enough to stimulate specific industrial projects in DeKalb County, Georgia. The formation of broad policy is one thing but encouraging specific businessmen to take entrepreneurial risks with the resulting increase in jobs is the very thing for which the local government officials are best suited.

In conclusion, I trust that this subcommittee will recognize that industrial revenue bonds are like Papa's mule; productive and working well, therefore, we hope you will focus on the tremendous benefits which have resulted from the program rather than to view abuses which make good headlines.

Thank you.

PART II

WRITTEN STATEMENT OF J. DAVID CHESNUT TO THE SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS & MEANS, HOUSE OF REPRESENTATIVES OF THE UNITED STATES

April 9, 1981

My name is David Chesnut and I am the general counsel for the Development Authority of DeKalb County, Georgia which is located in the metropolitan Atlanta area. I appreciate this opportunity to appear before this Subcommittee of Congress to state what I believe are the important points in favor of retaining and further encouraging industrial revenue bond financing.

The Authority which I represent has power to issue industrial revenue bonds in DeKalb County, Georgia. DeKalb County is a microcosm of the rural-suburban-urban blend of our country. Part of our county is actually within the city of Atlanta, part is very prosperous with many new businesses and industrial parks, part is rural, and part, unfortunately, is undeveloped. The Development Authority of DeKalb County working with the DeKalb County Chamber of Commerce and the DeKalb County Board of Commissioners considers it our obligation to encourage industry to locate where jobs are most needed and often where industry is not initially inclined to locate. We have adhered to a policy of issuing bonds only for those industries who would have located industry or jobs elsewhere but for the availability of tax-exempt financing.

Industrial revenue bonds are an important tool in promoting this economic development by businesses. In our county there are many businesses which would not otherwise make capital investment with the extremely high interest rates now in existence. The availability of tax-exempt financing makes projects feasible which would otherwise not be so. It has been our experience that the use of industrial revenue bonds has resulted in an increase in overall capital formation and employment. The magnitude of our results might seem quite modest in national statistics but they are very important to the people who live in DeKalb County, Georgia. It is my assumption that in the aggregate the many DeKalb County, Georgias in this nation by the use of this tool have created many jobs that would otherwise not exist.

The second beneficial result from the use of industrial revenue bonds is the expansion of the tax bases -- individual and corporate income taxes for the state government and federal government and increased ad valorem property taxes for DeKalb County. One example would be a manufacturing company who in 1977 was induced by the Authority to locate its facility in DeKalb County. We issued $1,525,000 of bonds for this company. Its payroll in 1976 prior to the issuance of bonds was $2,583,471 on which $322,324 was withheld for federal income taxes. In 1980 having created

153 new jobs its payroll had expanded to $5,130,283 with $702,499 withheld for federal income taxes and paid over $30,000 to the county in ad valorem taxes. Had the company borrowed this money conventional at 15% interest, taxable to the holder of the note, the federal government would have received $103,500 assuming the lender paid taxes at the highest tax rate with no offsetting expenses. The benefit to the U. S. Government from this industry is $276,500 per year courtesy of tax-exempt bonds.

I perhaps have a very simplistic view of our economic system, but it is my belief that what is hurting this country most is loss of time of people who want to work. Whether you are talking about material things which will never get produced or books that are never written, none of the things which we consider to be the results of the American Economic system have created themselves but have been created by people who have had an environment which allows them to work. In DeKalb County the use of industrial revenue bonds has allowed many small businesses to give individual employees this opportunity and the result has been more material goods produced and time not lost forever. If we look at our total gross national product it is merely the sum of time profitably spent and in my mind nothing which encourages this should ever be considered for elimination.

I have attached to my written comments a list of the industrial revenue bond issues which have been closed to date in DeKalb County, Georgia. Also attached is a list of companies to whom we have issued inducement resolutions. Approximately one-third of the companies have actually used tax-exempt financing, so one must be careful in considering reported figures and determine if they are bonds actually issued or merely agreements to issue bonds. An examination of these lists will show that the great majority of them are for small businesses whose very existence these economic times has imperiled. We are very proud of what we have been able to do to create an environment in which these businesses can continue in business and prosper and in the aggregate we believe our 34 bond issues totaling $53,518,750 have created more than 1886 new jobs. This represents $28,376.85 of private capital invested on a tax-exempt basis for each new job created.

It is our understanding that the main objection to industrial revenue bonds is that they are being used with increasing frequency to finance a wide range of facilities that are not industrial in nature and that industrial revenue bonds in effect provide a federal tax subsidy of a kind which cannot be controlled by the federal government. My response to this is that our Authority and the bond counsel with whom we have worked have exercised an extremely high standard in evaluating projects and from the list of projects which I referred to above it can be seen that none of these are abuses. As to the argument that the federal government does not have direct control or supervision over this subsidy, I think that this should be considered to be an advantage. There is no way that state development officials much less officials on the federal level can evaluate and react quickly enough to stimulate specific industrial projects in DeKalb County, Georgia. The formation of broad policy is one thing but encouraging specific businessmen to take entrepreneurial risks with the resulting increase in jobs is the very thing for which the Development Authority of DeKalb County and the DeKalb County Chamber of Commerce is best suited.

In conclusion, I trust that this subcommittee will focus on the tremendous benefits which have resulted from the industrial revenue bond program rather than to view abuses which make good headlines.

Thank you.

APPENDIX "A"

Name of Industry	Type of Industry	Potential Employment Levels	Actual Amount Of Issue	Date of Issuance
H. J. Heinz Company	Manufacturing-Food Processing	100	$2,400,000	09/23/76
Scientific-Atlanta, Inc.	Manufacturing/Warehousing Technical Instruments	10	$1,000,000	05/25/77
Bobbie Bailey (Our-Way, Inc.)	Manufacturing-Air Compressors	335	$1,000,000	05/27/77
Permite Corporation	Manufacturing-Specialty Paints	15	$ 450,000	03/31/77
Frito-Lay, Inc. (PepsiCo)	Manufacturing-Food Processing	15	$1,000,000	09/15/77
W. C. Harris	Warehouse/Distribution	32	$ 750,000	12/20/77
Container Corporation-Lithonia	Manufacturing-Plastic Drums	80	$3,300,000	12/27/77
Container Corporation-Stone Mountain	Manufacturing-Printing Press	15	$1,000,000	12/27/77
The Oren Corporation	Manufacturing-Insulation	150	$ 460,000	01/19/78
Noland Company	Warehouse Facility	100	$1,300,000	02/28/78
Lanier Bus. Products, Inc.	Warehouse/Office	97	$1,200,000	02/07/78
Sealy Mattress Co. Of Georgia, Inc.	Manufacturing-Mattresses	40	$1,200,000	07/06/78
Decatur News Publishing Company, Inc.	Manufacturing-Newspaper	15	$1,275,000	08/04/78

Name of Industry	Type of Industry	Potential Employment Levels	Actual Amount Of Issue	Date of Issuance
Kraft, Inc.	Manufacturing-Food Processing	35	$1,000,000	9/15/78
M. Bobbie Bailey	Manufacturing Air Compressors	80	$ 525,000	12/01/78
Haverty Furniture Companies, Inc.	Warehouse-Furniture	40	$ 900,000	12/14/78
The Gates Rubber Co.	Warehouse/Distribution/ Assembly	100	$5,200,000	05/02/79
Interfinancial, Inc.	Warehouse/Office	24	$ 900,000	08/29/79
Stone Container Corp.	Expansion/Equipment	35	$4,500,000	09/14/79
Duplex Products, Inc.	Manufacturing	50	$5,000,000	10/02/79
Epps Air Service, Inc.	Airport Facility	12	$1,000,000	11/28/79
Daines & Payne (Suspended Seating, Inc.)	Manufacturing/Distribution	50	$ 725,000	12/14/79
Daines & Payne (Suspended Seating, Inc.)	Equipment for 11/26/79 Project		$ 168,750	03/25/80
IC Products, Inc. (Pet, Inc.)	Manufacturing-Food Processing	125	$6,600,000	03/06/80
Alpine Engineered Products	Manufacturing	20	$ 750,000	04/28/80
Flexible Metal Hose	Manufacturing	24	$ 660,000	04/29/80
Dynamo Parents Club	Sports Facility	8	$ 350,000	06/06/80
Nokia, Inc.	Manufacturing	38	$1,155,000	06/27/80

Name of Industry	Type of Industry	Potential Employment Levels	Actual Amount Of Issue	Date of Issuance
New Hermes	Manufacturing	20	$ 800,000	08/21/80
Plant Improvement Co., Inc.	Corporate Hdqtrs.	15	$ 300,000	09/04/80
Rogers Bridge Co., Inc.	Corporate Hdqtrs.	15	$ 350,000	09/04/80
John H. Plant	Warehouse/distribution	10	$ 550,000	12/31/80
Old Dominion Freight Line	Freight Terminal	75	$1,000,000	01/09/81
NEL-United Associates	Bonded Warehouse	100	$4,250,000	02/11/81

DATE OF INDUCEMENT	NAME OF INDUSTRY	AUTHORIZED AMOUNT
5-17-76	Expanded Metal Corporation	5,000,000
6-14-76	Scientific-Atlanta	5,000,000
12-3-76	M. Bobbie Bailey	2,000,000
12-22-76	Suddath Van Lines	500,000
6-6-77	Pepsi Co., Inc. (Frito-Lay)	1,000,000
6-6-77	Container Corporation of America (St. Mtn.)	3,000,000
6-6-77	Container Corporation of America (Lithonia)	4,000,000
7-11-77	Noland Company	3,000,000
8-19-77	Lanier Business Products	2,000,000
8-19-77	M. D. Hodges Enterprises, Inc.	500,000
9-6-77	W. C. Harris & Company	900,000
9-6-77	Decatur News Publishing	2,500,000
9-6-77	The Oren Company	2,000,000
1-9-78	John W. Rooker	1,500,000
1-16-78	Sealy Mattress Co. of Georgia, Inc.	2,000,000
5-9-78	Alkaril Chemical Ltd.	2,500,000
6-6-78	Kraft, Incorporated	1,500,000
6-12-78	Haverty Furniture Company, Inc.	1,500,000
6-12-78	M. Bobbie Bailey	1,000,000
8-1-78	Osborn Transporation, Inc.	1,500,000
10-3-78	Shaheen & Company	1,000,000
11-7-78	Stone Container Corporation	6,000,000
	Robert S. Thanhauser, Jr.	600,000
12-5-78	Koppers Company, Inc.	2,500,000
	Concepts, Inc.	1,000,000
	Gates Rubber Company	6,000,000
1-4-79	Hearndon & Friedly (Alpine Engr. Products)	1,000,000
	Mathis Dairy/Alta Dena Dairy	3,000,000
2-6-79	Industrial Piping Supply Co.	350,000
	United States Gypsum	1,500,000
3-6-79	Weyerhaeuser Company	8,000,000
	Duplex Products, Inc.	5,200,000
	Kelgo International & Greenley Tool, Inc.	1,200,000
4-3-79	Epps Air Service	1,500,000
5-1-79	William R. Vargo	1,250,000
	Richard Myrick Company	7,000,000
6-5-79	Decatur News Publishing	2,500,000
	Rovema Packaging	1,000,000
	IREMCO Div. Corporation	1,500,000
7-10-79	Flexible Metal Hose (Daines & Paynes)	1,500,000
	Suspended Seating, Inc.	1,750,000
	Ellman's, Inc.	2,500,000
	Nokia, Inc.	7,000,000
	Mostafa Akhavan	10,000,000
8-7-79	Dymanos Parent Club, Inc.	500,000
	National Systems, Inc.	500,000
	Trepton, Murphree & Company	6,000,000
	Equifax, Inc.	10,000,000

APPENDIX "B"

DATE OF INDUCEMENT	NAME OF INDUSTRY	AUTHORIZED AMOUNT
8-22-79	159 Armour Group	2,500,000
9-11-79	Sullair Corp.	500,000
	Tom Willingham	2,500,000
	W. C. Harris & Company	500,000
	Dunwoody Sports Facility	1,000,000
	Rogers Bridge Company	300,000
11-26-79	Koltun, Markin & Rubel (Kolcraft Products)	1,500,000
	H. B. Fuller Co.	4,000,000
	Henning & Lisenby	1,300,000
	IC Products, Inc. (Pet, Inc.)	10,000,000
	M & M Products, Inc.	10,000,000
1-9-80	First United Corp.	5,000,000
	Southeastern Ventilating	2,500,000
	E. W. Bowman, Inc.	750,000
1-18-80	Rockdale Industries	1,500,000
2-5-80	ICC Industries, Inc.	3,000,000
	Chemical Sealing Corp.	250,000
3-11-80	Marshall's Inc.	1,000,000
	Canadian Steelmaster	1,000,000
4-7-80	New Hermes, Incorporated	1,500,000
	Depco, Inc.	750,000
5-6-80	Insilco, Inc. (M.A. LaGrone)	1,000,000
	American Agency Life	2,500,000
	Centel Communication, Inc.	1,500,000
	Babcock Management Corp.	2,000,000
6-10-80	Independence Square Partners	2,000,000
	John Plant (Maintenance Equipment Co.)	1,000,000
	Hano Business Forms, Inc.	3,000,000
6-25-80	Plant Improvement Co., Inc.	450,000
7-8-80	Select Service & Supply Co., Inc.	1,000,000
	Plastics Packaging, Inc.	1,000,000
8-5-80	Beverly Enterprises	4,500,000
	DeKalb Office Equipment Co.	1,000,000
9-9-80	Old Dominion Freight Line	1,500,000
10-7-80	Federated Dept. Stores	10,000,000
	Pathologists' Service Prof. Assoc. Inc.	3,500,000
	Refrigerated Transport	8,000,000
	Atlanta Mesco	750,000
11-4-80	Atlanta Big Boy Management	1,500,000
	Kellar & Stevens	3,000,000
	Allied Plastics	1,500,000
	George H. Jacobson (Pacific Saw & Knife)	1,500,000
11-4-80	WAB Supply	1,500,000
	National Computer Systems	1,500,000
	Crawford & Company	2,500,000
12-9-80	H. Donald Snapp	1,000,000
	Engineering-Science, Inc.	4,500,000
	Allegro Services, Inc.	1,000,000
	CTG Associates	750,000
	BR Leasing	2,000,000

DATE OF INDUCEMENT	NAME OF INDUSTRY	AUTHORIZED AMOUNT
1-6-81	All-Pak, Inc.	1,500,000
	Ewing Bros., Inc.	3,500,000
	Gale Linster	1,000,000
1-14-81	BBL Industries, Inc.	2,500,000
2-3-81	Hughes & Champ	750,000
	George Ingraham Company	1,250,000
3-3-81	Continental Forest Industries	6,500,000
	Cinetron Computer Systems, Inc.	1,000,000
	American Manufacturing Company	4,500,000
	Rockwall Properties (McNichols Company)	1,000,000
	Allied Safety Supply Co.	750,000
	Lanier Business Products	2,500,000
	Bennett, Pless, Brady & Anglin, Inc.	2,500,000
3-10-81	Hangar One, Inc.	3,500,000

[Pause.]

Senator D'AMATO. Our next panel consists of two local officials from the State of New York—two former colleagues of mine.

I think it is interesting that although both are local officials each represent's a county with a population in excess of a million people.

Their testimony will focus in on the importance and significance of industrial revenue activity—IDB's—as they relate very specifically to the economy of a local government.

We have Mr. Peter Cohalan, the county executive of Suffolk County, and Mr. Edward Rutkowski, the county executive of Erie County.

Mr. Cohalan?

STATEMENT OF PETER F. COHALAN, COUNTY EXECUTIVE, SUFFOLK COUNTY, STATE OF NEW YORK

Mr. COHALAN. Thank you, Mr. Chairman.

It is my privilege to have been invited to address the subcommittee today to speak to you about the local economic benefits of industrial revenue bonds.

I was encouraged to learn that the subcommittee had convened to consider this matter, and that you had asked representatives from local and State governments to testify because industrial revenue bonds have had, and hopefully will continue to have, a dramatic impact upon local efforts to attract and retain industry.

I have longer testimony which I have submitted for the record.

I come here today representing Suffolk County, N.Y.

I believe County Executive Rutkowski and I are speaking for a large number of local New York elected officials.

Suffolk County comprises the easterly two-thirds of Long Island which lies due east from New York City. The county encompasses 926 square miles and in 1980 had a population of about 1.3 million people.

The westerly end of our county is highly developed and industrialized. The easterly end is mostly farmland and is a tourism center for New York State.

There are more than 56,000 companies located on Long Island in the counties of Nassau and Suffolk. The majority of these are small businesses with under 250 employees.

Manufacturing represents one of the fastest-growing sectors of our economy, with approximately one-quarter of all our nonfarm employment being in manufacturing.

However, during the past few years, we have seen a continuous decline in the number of new building permits issued. This decrease in the new industrial construction can be directly linked to high interest rates, high energy costs, and the high cost of transportation affecting the Northeast in general and Suffolk County in particular.

The continuing availability of industrial revenue bonds will hopefully enable Suffolk County to offset these liabilities—in particular, the constraint that record-high interest rates have placed upon industrial expansion.

In 1969, in an effort to become more competitive with other areas of the country, the New York State Legislature enacted the Industrial Development Agency Act. It was believed this legislation would allow New York State to become more competitive in attracting new industry.

This act provides for the establishment of local IDA agencies. In Suffolk County, we have four operating IDA agencies, including the counties.

The IDA's in Suffolk County closed 41 bond issues totaling over $80 million during this past year. The total actual number of new jobs created during this period by financed firms was 2,574, which was an increase of 83 percent over existing employment at the time of application.

Planners consider a ratio of 2 to 1 as a conservative multiplier to estimate the number of additional jobs which are generated by the expenditure of new wages and salaries. Therefore, it can be estimated that the issuance of what we call IDB's in Suffolk County has been responsible for the creation of over 5,000 additional jobs in our local community.

Each of these new employees pays State and Federal income tax, and we project that almost $36 million is paid in Federal income tax by all of these new workers.

Total additional plant space occupied by these firms is 2 million square feet. Assuming property taxes of $1 per square foot, this total new plant space will generate local property tax revenues of $2 million a year.

Another powerful tool used in New York State to attract and retain industry is the New York State Job Development Authority. The JDA is a public-benefit corporation of New York created by constitutional amendment in 1961. It has the authorization to issue State guaranteed bonds and notes to make low-interest, tax-exempt loans to companies for the creation of jobs.

Priority for funding is generally given to firms which cannot obtain conventional financing for the entire cost of their proposed project.

Suffolk County businesses have been a major recipient of the $183 million loaned by the JDA as second mortgage financing up to this time.

Of all loans made in the State of New York, 35 percent have been placed in the Nassau-Suffolk-Long Island-Bicounty area, 276 loans having been made to Suffolk County. This has leveraged $50 million in loans into $149 million total for new plants and equipment. Not $1 of public money has been used.

This low-interest funding mechanism is vital to the continued growth of the small young firms which make up the largest part of the Long Island business community.

On August 24, the U.S. Treasury Department issued Revenue Ruling 81-216. This rule took effect immediately and was not subject to a review or comment period by the affected parties.

This rule has thrown the industrial development bonding market into a state of disarray.

The ruling will have this effect: Because the ruling reversed a number of recent letter decisions given to IDA's and other State funding authorities, no one knows what to do at this stage of the game.

Second, since it took effect immediately, it stopped a number of bonding transactions which were underway—some of them on Long Island.

Revenue Ruling 81-216 has four major thrusts. It overturned a prior Treasury decision that small-issue IDB's could be aggregated into larger issues, sold as a package, and still retain their tax-exempt status. This benefits small business.

It disallowed the practice whereby separate IDA's could authorize one part of a larger bond issue for a company wishing to establish multiple locations around the State or region.

It disallowed the pooling of IDB's into what has been termed a municipal investment trust.

It disallowed the practice of backing IDB's with other Federal or State loan guarantees–again, hurting small business.

The immediate effect of the ruling has been to chill the market. The long-term effect will be to increase the administrative costs to agencies, such as our State JDA which formerly was able to achieve some measure of administrative efficiency by aggregating IDB's, thereby cutting down on paperwork, processing fees, and issuing costs.

There is already growing apprehension that the ruling is just the first, and that others further limiting the use of IDB's will be forthcoming.

There is also a persistent rumor that the administration is about to submit a bill calling for an immediate halt to IDA financing.

I would like to urge that some positive steps be taken to quell the rumors circulating and to deal with the IDB matter in such a manner that will allow for an open discussion of the issue and adequate legislative consideration.

I firmly believe that industrial revenue bonds have had a positive impact upon our economy on Long Island. The availability of this kind of financing has accounted for substantial major new industrial construction and business expansion in our county.

As I have already detailed, it is my belief that a majority of new industrial expansion occurring within the county would not otherwise have occurred without the existence of the industrial bond funding mechanism.

If reform is needed, then let us make the reforms in a positive fashion.

There has been a move during the Reagan administration to return power to the States. I believe that as part of this trend the majority of regulations governing the use of IDB's should be left to the States to enact.

I further believe that if any new Federal legislation is enacted, it should deal solely with setting restrictions on the use of IDB's which would eliminate any abuses that exist, yet leave the individual States free to govern the day-to-day administration of the program and to adapt the program to regional and intrastate needs.

Until interest rates start to return to a reasonable and realistic level, IDB's are the only financing mechanism which can be used to stimulate local development and production and to create new jobs.

Thank you, again, for providing me the opportunity to testify before you today.

I will be happy to answer any questions at the appropriate time.

Senator D'AMATO. Thank you very much.

County Executive Rutkowski?

STATEMENT OF EDWARD J. RUTKOWSKI, COUNTY EXECUTIVE, COUNTY OF ERIE, STATE OF NEW YORK

Mr. RUTKOWSKI. Thank you very much, Mr. Chairman.

I deeply appreciate the opportunity to testify before your committee.

I could begin my remarks with a litany of statistics, the kind with which you are all too familiar, about the economy of Erie County, the second largest urban area in New York State.

The numbers would tell of a once-thriving industrial economy which has seen nearly 100 factory closings or cutbacks in the past decade and a loss of more than 30,000 manufacturing jobs. They would also tell of continuing high unemployment, currently at 10 percent, and continuing erosion of the basic heavy industries which once fueled the economy of Buffalo and Erie County.

However, I would rather tell you of the recovery that we have begun—of the first steps we have taken on the still long road back to economic health. Above all, I would like to tell you what has made these steps possible, because I have come here today to urge you to preserve the small issue industrial revenue bond, one of our most powerful instruments for achieving that recovery.

Erie County's long-term economic decline always accelerated during periods of national cyclical slowdown.

It reached a peak in August 1977 when 3,000 steelworkers lost their jobs due to a permanent curtailment in operations by a local steel plant. We had just begun a reorganization of our countywide economic development activities. This massive layoff only served to focus our efforts on the development of a long-term strategy for recovery.

With an EDA title IX economic development planning grant, we undertook an exhaustive series of studies and analyses to produce the Buffalo area economic adjustment strategy. This is our economic blueprint for creating 8,000 jobs and achieving a shift in our economic base from heavy industry to diverse light and medium manufacturing and service industries.

We identified those industries that held the greatest potential for our economy, based upon both national growth trends and a match between industrial requirements and regional assets. Then we established six programs for realizing that potential.

One of these six is a program of financial assistance which provides incentives for expansion and retention of existing Erie County target industries, as well as inducement for new firms to locate in our area.

Along with other financial incentives, industrial revenue bonds have been a key to our success in retaining or expanding firms in targeted industries.

Between January of 1979 and the end of September of 1981, we issued 56 bonds, totaling $125 million and creating approximately 2,500 new jobs.

In 1979 and 1980, two-thirds of all bonds issued financed firms in targeted growth industries. An additional 11 percent were in industries identified for retention.

Equally significant is the fact that over 85 percent of the companies receiving assistance through these bond issues were small businesses.

All of us involved in economic development have come to realize it is primarily to small businesses that we must look for our economic future. Our experience has borne out the fact that they are the greatest source of economic growth and job expansion, accounting for up to 85 percent of the Nation's new jobs in the private sector.

Yet the measures adopted in the Economic Recovery Act of 1981, important as they are for promoting real growth in our national economy, promise little for small firms in capital-hungry stages of growth.

To these, tax relief is at best a future promise and not a current resource. The tax cut and business tax reform proposals are no substitute for industrial revenue bonds and other direct and indirect Federal subsidies.

By reducing the cost of capital and providing other clearly identifiable savings, tax-exempt IRB's provide a certainty of benefits which materially reduce risk to an investor and increase the probability of success for a venture.

By contrast, tax-based incentives are most effective in more mature stages of a business when profitability is assured. Therefore, they have less influence in investment decisions for high risk projects—the typical small business expansion.

We recognize that the growth in tax-exempt issues represents a problem for our national budget. We also recognize that in many instances these bonds are often misused—issued for purposes other than to induce basic economic activity.

In Erie County, through 1980, we issued only one commercial revenue bond. This year we are involved in four additional issues, each of which will finance an essential component of the city of Buffalo's downtown revitalization program. They are in urban renewal areas and are generally accompanied by urban development action grants.

I believe our program is exemplary in restricting the use of the bond to basic industries and to commercial projects which set in motion major redevelopment of distressed areas.

Our major and universally applied standard, in addition to net new jobs created, is this: Can this project occur without the bond? Bonds are not issued in Erie County if the answer is yes.

We urge you to recognize the unique effectiveness of the small issue in promoting the small business investment so vital to Erie County and other areas attempting to recover from economic decline.

To eliminate abuse, limit their growth and excessive costs to the Treasury, we urge that IRB's be targeted toward distressed areas and that stringent restrictions be placed on the use of IRB's for commercial projects.

In conjunction with targeting and restricted commercial uses, we recommend that the maximum tax-exempt limit and capital expenditure limit be adjusted under certain circumstances.

While such changes can take many forms, the following illustrates one set of alternatives to consider:

One, in general, restrict small issue industrial revenue bonds to industrial uses, including warehousing and distribution.

Two, again, in general, retain the current capital expenditure limitation and reduce the maximum tax-exempt issue amount to $5 million. This will reinforce small business capital formation benefits but limit the usefulness of small issues for branch operations of large firms.

Three, designate target areas on the basis of substantial and persistent unemployment, where capital expenditure limitations would be waived and the maximum tax-exempt issue increased to $20 million.

Four, permit commercial revenue bond projects only within those designated target areas and only if such projects are integral and necessary to a federally sponsored redevelopment program.

Five, if urban enterprise or job creation zone legislation is enacted for highly targeted, distressed, inner-city areas, all capital expenditure and maximum tax-exempt issue limits should be waived in these zones.

I am confident that Buffalo and Erie County will be restored to an economic strength equal to that of our days as a vibrant center of industry.

We have achieved a remarkable and unprecedented cooperation and unity in our determination to realize our goal. However, we would be severely, and perhaps insurmountably, hampered in our efforts without the use of the small-issue tax-exempt bonds.

This concludes the written portion of my testimony. I would just like to digress a bit.

We are not here asking for handouts. We are here to ask for something in which we can help ourselves.

Peter and I are county executives of two counties. I have over a million people in my county; Peter has over a million people in his county. I have a budget approaching almost $600 million but I can only control about 10 percent of that. The Federal and State governments control about 85 to 90 percent of our budget.

Sometimes we are like the boxer in the ring who is being pummeled by his opponent. The bell rings and the boxer goes down. He sits in his corner all bloodied and bruised and battered. His manager whispers in his ear: Kid, you are doing great; the guy hasn't laid a glove on you. Whereupon the boxer turns to his manager and says: If that is the case, do me a favor. Keep an eye on the referee because somebody out there is beating the heck out of me. [Laughter.]

We feel that there are certain things that we can control in county government. There are certain other things that we cannot control.

The industrial revenue bonds are the guts of our economic program at the local level. It is the key to economic development in Erie County. I just cannot tell you how important that is to our survival.

We want to make sure that we have a strong private economy and that we can transfer as many jobs out of the public sector into the private sector and expand that job base so that we can have real growth in Erie County.

Not to drag this on any longer but just to accentuate the impact that the Federal and State governments have on our revenue sources, in 1976 my tax base expanded by $45 million, basically because of new housing starts. Because of high inflation, high mortgage rates, and because of high interest rates, that base has gone from $45 million in 1976 to $500,000 in 1981.

That is a dramatic decrease in my revenues. I did not cause that; Peter did not cause that in his county. Yet we have to live with those consequences.

We are constantly being bombarded by these kinds of problems.

When there is a vehicle at the local level whereby we can stimulate and help create jobs to help ourselves, we should be able to have that kind of vehicle. An IRB is that kind of vehicle.

I would just urge you, again.

I come from a very competitive background of professional athletics. I grew up believing that if I was successful, I would be rewarded; I would not be punished.

We have identified successful track records with IRB's in his county and in my county. Do not punish us; reward us. Punish those people who are abusing the program; get those turkeys out of the program. Do not lump us in with those individuals or those States and make us pay the price for their abuse of the program.

Senator D'AMATO. Mr. County Executive, let me ask you this: Have you considered a new career—giving up elective office to take on a responsible position, say, in Treasury as an enlightened bureaucrat? [Laughter.]

Sometimes we think that we serve the public best by being in elective positions, but I have become somewhat cynical and wonder whether maybe the power—there is other talk that it is staff which runs the Hill. That may or may not be true up here, but it is certainly the bureaucrats who run the dynamics of our executive branch.

You make a very, very telling story—both your testimony and County Executive Cohalan's.

Here is a program which has done much to avoid what would be a horrible situation. It is untenable for many small corporations which are successful to exist without it.

Were it not there, what would the consequences be in terms of employment, in terms of other spinoff opportunities, in terms of the local tax base and in terms of other intangibles?

When a business expands or comes into existence in an economically depressed area, how many other businesses may be attracted in as a result? How many other businesses that may have been losing hope will then say: I see that there is that kind of economic opportunity?

It is that unwritten, unseen, unmeasured, and in many cases, additional incremental value that is added by this particular program.

It seems to me that those who are making these rulings have probably never in their lives been involved in any form of administration or tried to hold together a local or State government.

As you say, it is the boxer who is bloodied and pummeled. It is the bureaucrat in the corner who is saying: You are doing a good job; they have not laid a glove on you.

I am going to borrow that story if I might. I know Senator Dixon certainly is.

Senator Dixon, do you have any questions?

Senator DIXON. Mr. Chairman, I just want to say that I thank Mr. Cohalan and Mr. Rutkowski for their excellent contribution to this hearing.

I might further suggest that there were a number of things suggested here by this panel that we should bear in mind in the markup of legislation that we may ultimately, and I expect definitely will ultimately, consider concerning answering some of the objections to the existing practices.

Thank you very much.

Senator D'AMATO. We thank you very much for coming in.

[The prepared statements of Mr. Cohalan and Mr. Rutkowski follow:]

STATEMENT OF PETER F. COHALAN
COUNTY EXECUTIVE, SUFFOLK COUNTY, NEW YORK
BEFORE THE SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT
SMALL BUSINESS COMMITTEE, UNITED STATES SENATE
OCTOBER 5, 1981

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

IT IS MY GREAT PRIVILEGE TO HAVE BEEN INVITED HERE TODAY TO SPEAK TO YOU ABOUT THE LOCAL ECONOMIC BENEFITS OF INDUSTRIAL DEVELOPMENT BONDS. I WAS ENCOURAGED TO LEARN THAT THE SUB-COMMITTEE HAD CONVENED TO CONSIDER THIS MATTER AND THAT YOU HAD ASKED REPRESENTATIVES FROM LOCAL AND STATE GOVERNMENTS TO TESTIFY; BECAUSE INDUSTRIAL DEVELOPMENT BONDS HAVE HAD, AND HOPEFULLY WILL CONTINUE TO HAVE, A DRAMATIC IMPACT UPON LOCAL EFFORTS TO ATTRACT AND RETAIN INDUSTRY.

INTRODUCTION TO SUFFOLK COUNTY

I COME HERE TODAY REPRESENTING SUFFOLK COUNTY, NEW YORK.

SUFFOLK COUNTY LIES AT THE EASTERN EXTREME OF LONG ISLAND, WHICH LIES TO THE EAST OF NEW YORK CITY. THE COUNTY ENCOMPASSES 922 SQUARE MILES, AND IN 1980 HAD A POPULATION EXCEEDING 1.2 MILLION. THE WESTERN END OF THE COUNTY IS HIGHLY DEVELOPED AND INDUSTRIALIZED; THE EASTERN END IS COMPRISED OF MOSTLY FARMLAND AND IS A TOURISM CENTER FOR NEW YORK STATE.

IN 1972, SUFFOLK AND ITS NEIGHBORING COUNTY TO THE WEST, NASSAU, WERE DESIGNATED A STANDARD METROPOLITAN STATISTICAL AREA, DISTINCT AND SEPARATE FROM THE NEW YORK CITY SMSA, BY THE U.S. OFFICE OF MANAGEMENT AND BUDGET. THE LONG ISLAND BI-COUNTY SMSA, POPULATED BY 2.6 MILLION PEOPLE, IS RANKED 11TH IN POPULATION, 3RD IN SPENDABLE INCOME PER HOUSEHOLD, AND THE 9TH LARGEST SMSA AMONG THE 288 DESIGNATED AREAS.

SUFFOLK COUNTY ECONOMY

SUFFOLK COUNTY HAS A LONG HISTORY OF COMMERCIAL/INDUSTRIAL DEVELOPMENT AND EXPANSION. THE FIRST PERSON TO SET FOOT IN SUFFOLK COUNTY FROM EUROPE WAS ADRIAN BLOCK, A DUTCH TRADER-EXPLORER, WHO LANDED AT MONTAUK POINT IN 1614, SEEKING PRESUMABLY A NEW TRADING AREA. OUR OLDEST INDUSTRY, FISHING, IS DIRECTLY LINKED TO THE SEA WHICH SURROUNDS US; WITH THE FIRST WHALES BEING TAKEN OFF OF SOUTHAMPTON IN 1643.

AFTER OUR INITIAL START IN THE FIELDS OF AGRICULTURE AND AQUACULTURE, WE DIVERSIFIED. WE HAVE LONG BEEN DOMINANT IN THE FIELD OF AVIATION. LONG ISLAND HAS BEEN KNOWN SINCE THE 1940'S FOR ITS CONTRIBUTIONS TO THE MILITARY AIRCRAFT INDUSTRY AND SINCE THE 1960'S FOR ITS CONTRIBUTIONS TO AEROSPACE.

THERE ARE MORE THAN 56,000 COMPANIES LOCATED ON LONG ISLAND. THE MAJORITY OF THESE ARE SMALL BUSINESSES, WITH UNDER 250 EMPLOYEES. MANUFACTURING REPRESENTS ONE OF THE FASTEST GROWTH SECTORS OF OUR ECONOMY. APPROXIMATELY 1/4 OF ALL OUR NON-FARM EMPLOYMENT IS IN MANUFACTURING. HOWEVER, DURING THE PAST FEW YEARS, WE HAVE SEEN A CONTINUOUS DECLINE IN THE NUMBER OF NEW BUILDING PERMITS ISSUED THIS DECREASE IN NEW CONSTRUCTION CAN BE LINKED DIRECTLY TO THE HIGH INTEREST RATES, THE HIGH ENERGY COSTS, AND THE HIGH TRANSPORTATION COSTS AFFECTING SUFFOLK COUNTY IN PARTICULAR, THE NORTHEAST IN GENERAL. FIRMS LOCATING IN SUFFOLK COUNTY AT THE TIP OF LONG ISLAND HAVE LIMITED TRANSPORTATION ACCESS, AND MUST FIGURE INCREASED TRANSPORTATION COSTS INTO ANY CALCULATIONS BEING MADE ON EXPANSION.

CURRENTLY SUFFOLK COUNTY HAS 22 MILLION SQUARE FEET OF EXISTING INDUSTRIAL SPACE, 3 MILLION SQUARE FEET UNDER CONSTRUCTION, AND 8 MILLION SQUARE FEET PROPOSED. IN 1980, 14 NEW FIRMS MOVED INTO SUFFOLK, WITH 287

NEW EMPLOYEES. ONE HUNDRED NINETY NINE EXISTING COMPANIES EXPANDED THEIR SPACE. THESE 199 EXPANSIONS AFFECTED 2,857 EMPLOYEES.[1] WHEREAS THE NATION AS A WHOLE HAS AN UNEMPLOYMENT RATE IN 1981 OF 7.3%, SUFFOLK COUNTY'S UNEMPLOYMENT RATE IS 6.8%. HOWEVER, THIS REPRESENTS AN INCREASE SINCE 1980, WHEN OUR UNEMPLOYMENT RATE WAS 6.2%.

DURING THE NEXT TEN YEARS ECONOMIC CONSULTANTS HIRED BY THE COUNTY HAVE PREDICTED CONTINUING, BUT SLOWING, GROWTH. THE REASONS THEY CITE FOR THE POTENTIAL FOR EXPANSION ARE: LOWER TAX RATES IN SUFFOLK COUNTY; LOWER LAND COSTS; AND, AN AVAILABLE LABOR POOL OF TRAINED EMPLOYEES (THE AVERAGE EDUCATION LEVEL OF LONG ISLAND RESIDENTS IS 12.4 YEARS) IDEALLY SUITED FOR HIGH TECHNOLOGY, SERVICE INDUSTRIES, AND LIGHT MANUFACTURING WORK. NEGATIVE FACTORS AFFECTING OUR GROWTH POTENTIAL, AS CITED PREVIOUSLY, ARE HIGH INTEREST RATES, HIGH ENERGY COSTS, AND HIGH TRANSPORTATION COSTS. THE CONTINUING AVAILABILITY OF INDUSTRIAL DEVELOPMENT BONDS (IDBs) WILL, HOPEFULLY, ENABLE SUFFOLK COUNTY TO OFFSET THESE LIABILITIES TO GROWTH; IN PARTICULAR, THE CONSTRAINT THAT HIGH INTEREST RATES HAVE PLACED UPON INDUSTRIAL EXPANSION.

SUFFOLK COUNTY HAS A LONG HISTORY OF PROVIDING INCENTIVES FOR NEW FIRMS TO RELOCATE TO OUR AREA. THE EXTENSIVE AND DIVERSIFIED SMALL BUSINESS COMMUNITY ON LONG ISLAND HAS HELPED TO KEEP THE BI-COUNTY REGION AHEAD OF THE STATE AND NATION IN TERMS OF ECONOMIC GROWTH. SUFFOLK COUNTY HAS A HIGHLY SKILLED AND TECHNICALLY ORIENTED WORK FORCE, NEW INDUSTRIAL PARKS WITH IMPRESSIVE AND IMAGINATIVE NEW BUILDINGS, AND AN EXTENSIVE NETWORK OF HIGH TECHNOLOGY FIRMS WHICH CAN SUPPLY MATERIALS WHICH ARE NEEDED BY FIRMS

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[1] LILCO Almanac, 1981, Long Island Lighting Company.

WANTING TO MOVE TO THIS AREA. LOCAL BUSINESS HAS HAD THE COOPERATION OF LOCAL GOVERNMENTS, WHICH HAVE WORKED TO PROVIDE INCENTIVES FOR INDUSTRIAL EXPANSION, INCLUDING THE AVAILABILITY OF IDB FINANCING.

NEW YORK STATE IS ALSO FAVORABLY DISPOSED TOWARD OFFERING INCENTIVES TO FIRMS LOCATING IN THE STATE. THE STATE HAS MADE A CONCERTED EFFORT TO LOWER THE COST OF DOING BUSINESS, WITH PERSONAL AND BUSINESS TAX CUTS OF OVER $1.6 BILLION; AND, BY PROVIDING FINANCING THROUGH THE NEW YORK STATE JOB DEVELOPMENT AUTHORITY (JDA).

INDUSTRIAL DEVELOPMENT AGENCIES IN NEW YORK STATE[2]

THE USE OF IDBs HAS BEEN EXTENSIVE IN THE SOUTHERN AND WESTERN STATES DURING THE PAST 40 YEARS. THE NORTHEASTERN STATES WERE RELATIVELY LATE STARTERS IN EMPLOYING THIS ECONOMIC TOOL. IF THE IDBs ARE NOW DROPPED THE NORTHEASTERN STATES, WHO ARE SADDLED WITH ANTIQUATED PLANTS AND INFRASTRUCTURE, WOULD BE LEFT WITHOUT ANY SUBSTANTIVE MEANS OF GENERATING OR ATTRACTING MUCH NEEDED NEW INVESTMENT CAPITAL.

IN 1969, IN AN EFFORT TO BE MORE COMPETITIVE WITH OTHER AREAS OF THE COUNTRY, THE NEW YORK STATE LEGISLATURE ENACTED THE INDUSTRIAL DEVELOPMENT AGENCY ACT (ARTICLE 18A-GENERAL MUNICIPAL LAW L-1969, c.1030). THIS ACT PROVIDES FOR THE ESTABLISHMENT OF LOCAL INDUSTRIAL DEVELOPMENT AGENCIES (IDAs): EACH OF WHICH HAS TO BE CREATED BY A SPECIAL ACT OF THE NEW YORK STATE LEGISLATURE. EACH LOCAL IDA OPERATES UNDER THE GENERAL GUIDELINES SET FORTH IN ARTICLE 18A.

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[2] Material summarized from New York State Industrial Development Agencies; The Objectives in 1969 The Reality of 1981, Assembly Committee on Oversight Analysis and Investigation, Dennis Gorski, Chairman, 1981

AS OF OCTOBER, 1980, THERE WERE 151 IDAs IN NEW YORK STATE. THESE AGENCIES HAVE ISSUED BONDS TOTALLING OVER $1 BILLION SINCE THE FIRST BOND WAS ISSUED IN 1970. THIS FINANCING HAS INVOLVED OVER 600 PROJECTS. THE INTENT OF 18A WAS TO ALLOW THE LEGISLATURE TO CREATE LOCAL IDAs TO FULFILL A NEED WHICH EXISTED WITHIN SPECIFIC COMMUNITIES. THE INTENT WAS ALSO TO PURSUADE OUT-OF-STATE INDUSTRY TO RELOCATE IN TOWNS, VILLAGES, CITIES AND COUNTIES WITHIN NEW YORK STATE. IT WAS BELIEVED THAT THIS LEGISLATION WOULD MAKE NEW YORK STATE MORE COMPETITIVE IN ATTRACTING NEW INDUSTRY.

EACH LOCAL IDA CREATED IN NEW YORK STATE IS A PUBLIC BENEFIT CORPORATION. THEY ARE EMPOWERED TO ISSUE TAX EXEMPT SECURITIES FOR THE ACQUISITION OR CONSTRUCTION OF INDUSTRIAL, MANUFACTURING, WAREHOUSEING, AND CERTAIN COMMERCIAL RESEARCH AND RECREATIONAL FACILITIES. THE IDA ISSUES REVENUE BONDS IN ITS OWN NAME, BASED ON THE CREDIT RATING OF THE INDIVIDUAL COMPANY. THE BOND IS SECURED BY A FIRST MORTGAGE ON THE PROPERTY, WITH BANKS BEING THE USUAL UNDERWRITERS. AFTER CONSTRUCTION IS COMPLETED THE IDA SELLS OR LEASES THE FACILITY BACK TO THE COMPANY. IF IT IS LEASED BACK THE RESULTING REVENUES ARE USED TO REPAY THE PRINCIPAL AND INTEREST ON THE BONDS AND WHEN THE BOND ISSUE IS RETIRED THE PLANT IS THEN SOLD TO THE FIRM FOR A NOMINAL SUM.

BONDS ISSUED THROUGH IDAs ARE EXEMPT FROM FEDERAL AND STATE TAXATION. ALL REAL PROPERTY OWNED BY AN INDUSTRIAL DEVELOPMENT AGENCY IS EXEMPT FROM PROPERTY TAXES, BUT AN ARRANGEMENT MAY BE MADE WHERE PAYMENTS-IN-LIEU OF TAXES ARE MADE TO THE LOCAL TAXING JURISDICTIONS. ALL IDA BUILT FACILITIES ARE ALSO EXEMPT FROM THE NEW YORK STATE MORTGAGE TAX, AND THE MATERIALS USED IN THEIR CONSTRUCTION ARE EXEMPT FROM STATE SALES TAX. THE GORSKI REPORT STATES THAT THE USUAL INTEREST RATE ON IDA BONDS IS BETWEEN 65-75% OF THE EXISTING PRIME LENDING RATE FOR LOANS THROUGH CONVENTIONAL FINANCING.

EVERY COUNTY IN NEW YORK STATE, OUTSIDE OF NEW YORK CITY, HAS AN IDA. IT APPEARS THAT COUNTY IDAs ARE CLEARLY THE MOST ACTIVE PARTICIPANTS IN THIS PROGRAM. IN NEW YORK STATE, EXCLUDING NEW YORK CITY, 89% OF ALL IDBs WERE ISSUED BY COUNTY IDAs.

THERE HAVE BEEN SOME INSTANCES IN NEW YORK STATE WHERE COMMERCIAL TYPE PROJECTS WERE FUNDED. THIS IS BECAUSE STATE LAW CURRENTLY PERMITS COMMERCIAL PROJECTS TO BE FUNDED. THERE HAVE ALSO BEEN A FEW INSTANCES WHERE MAJOR CORPORATIONS HAVE RECEIVED FUNDING. THESE INSTANCES, HOWEVER ARE THE EXCEPTION RATHER THAN THE RULE.

INDUSTRIAL DEVELOPMENT AGENCIES WITHIN SUFFOLK COUNTY

IN SUFFOLK COUNTY THERE ARE SEVEN INDUSTRIAL DEVELOPMENT AGENCIES: SUFFOLK COUNTY IDA, THE TOWN OF ISLIP IDA, THE TOWN OF BABYLON IDA, THE TOWN OF BROOKHAVEN IDA, THE TOWN OF RIVERHEAD IDA, THE TOWN OF SOUTHAMPTON IDA, AND THE TOWN OF EAST HAMPTON IDA. OF THESE, THREE HAVE JUST BEEN ESTABLISHED WITHIN THE RECENT PAST AND HAVE ISSUED NO BONDS (RIVERHEAD, SOUTHAMPTON, EAST HAMPTON).

FOLLOWING IS A BRIEF LOOK AT THE ACTIVITY OF THE OTHER FOUR AGENCIES:

1- FORTY-ONE BOND ISSUES HAVE BEEN CLOSED TOTALING $80,000,000 FOR 1980-81. OF THESE ISSUES, 66% WERE MADE BY THE COUNTY AGENCY, REPRESENTING 73% OF THE TOTAL DOLLAR AMOUNT. THE TOTAL NUMBER OF NEW JOBS CREATED DURING THIS PERIOD BY THESE FIRMS WERE 2,574; AN INCREASE OF 83% OVER THEIR EXISTING EMPLOYMENT AT THE TIME OF APPLICATION (3.118). THESE NEW JOBS ALSO REPRESENT AN INCREASE IN TOTAL PAYROLL FROM $42.8 MILLION TO $80.2 MILLION, OR AN 87% INCREASE.

2A) THE TOTAL ADDITIONAL PLANT SPACE OCCUPIED BY THESE FIRMS IS 2.0 MILLION SQUARE FEET, OF WHICH 63%, OR 1.26 MILLION SQUARE FEET IS NEW CONSTRUCTION. ASSUMING AN AVERAGE COST OF $35 PER SQUARE FOOT THIS NEW CONSTRUCTION COST APPROXIMATELY $44 MILLION; WHICH WAS PAID TO OUR LOCAL CONSTRUCTION INDUSTRY.

B) ASSUMING PROPERTY TAXES OF $1.05 PER SQUARE FOOT, THIS TOTAL NEW PLANT SPACE WILL GENERATE LOCAL PROPERTY TAX REVENUES OF $2.0 MILLION PER YEAR.

3) PLANNERS CONSIDER A RATIO OF 2:1 AS A CONSERVATIVE MULTIPLIER TO ESTIMATE THE NUMBER OF ADDITIONAL JOBS WHICH ARE GENERATED BY THE EXPENDITURE OF NEW WAGES AND SALARIES. THEREFORE, BASED UPON NEWLY CREATED JOBS ONLY, IT CAN BE ESTIMATED THAT THE ISSUANCE OF THESE IDBs HAS ALSO BEEN RESPONSIBLE FOR THE CREATION OF OVER 5,000 ADDITIONAL JOBS IN THE LOCAL COMMUNITY.

4) IN 1980, A RECORD $38 MILLION OF INDUSTRIAL REVENUE BONDS WERE CLOSED BY THE SUFFOLK COUNTY INDUSTRIAL DEVELOPMENT AGENCY, REPRESENTING AN 81% INCREASE OVER 1979. THIS FINANCING WAS RESPONSIBLE FOR THE CREATION OF OVER A THOUSAND NEW DOCUMENTED JOBS. (CHART I)

(CHART I)
SUFFOLK COUNTY INDUSTRIAL DEVELOPMENT AGENCY
SUMMARY 1979 - 1980

	1979	1980	INCREASE 1979 -1980	PERCENT INCREASE
Approved IDA Transactions	10	22	+ 12	+ 120%
Dollar Amount	$32,803,219	$57,917,405	+ $25,114,186	+ 77%
1st Year Employment	1,301	2,856	+ 1,555	+ 119%
1st Year Payroll	$14,847,020	$44,324,308	+ $29,477,288	+ 199%
Closed IDA Transactions	9	14	+ 5	+ 56%
Dollar Amount	$21,080,000	$38,235,000	+ $17,155,000	+ 81%
1st Year Employment	1,573	2,812	+ 1,239	+ 79%
1st Year Payroll	$19,103,000	$44,084,161	+ $24,981,161	+ 131%

A 1980 SUMMARY OF THE
SUFFOLK COUNTY INDUSTRIAL DEVELOPMENT AGENCY'S
INDUSTRIAL REVENUE BOND FINANCING PROGRAM

Suffolk County Industrial Development Agency
December 31, 1980

IT IS INTERESTING TO NOTE THAT IN A SURVEY OF 19 FIRMS (WHICH USED IDB FINANCING THROUGH THE COUNTY AGENCY) THE ACTUAL NEW EMPLOYMENT GENERATED EXCEEDED THE FIRMS PROJECTIONS FOR NEW EMPLOYMENT ON THEIR INITIAL APPLICATION BY MORE THAN 25%.

MOST OF THE IDBs AUTHORIZED HAVE INVOLVED A FIRM EITHER MOVING FROM LEASED SPACE TO A NEW PURCHASED FACILITY, OR EXPANSION OF AN EXISTING FACILITY. THE TYPES OF FIRMS THAT HAVE BEEN AUTHORIZED RANGE FROM: A COMPANY THAT MANUFACTURERS POLLUTION CONTROL PRODUCTS AND FLUID HANDLING AND FILTRATION EQUIPMENT; TO AN IMPORT AND EXPORT FIRM; TO A FIRM THAT MANUFACTURERS MICRO-COMPUTERIZED LATHES THAT PRODUCE COMPLEX MACHINE PARTS.

I HAVE APPENDED TO THIS TESTIMONY (APPENDIX A) EXCERPTS FROM LETTERS WRITTEN TO THE SUFFOLK COUNTY IDA FROM FIRMS RECEIVING IDBs. THE STATEMENTS FROM THESE FIRMS, I BELIEVE, PROVIDE SOLID TESTIMONY TO THE BENEFITS RECEIVED FROM THIS PROGRAM.

NEW YORK STATE JOB DEVELOPMENT AUTHORITY

THE NEW YORK STATE JOB DEVELOPMENT AUTHORITY (JDA) IS A PUBLIC BENEFIT CORPORATION OF THE STATE, CREATED BY A CONSTITUTIONAL AMENDMENT IN 1961. THE JDA HAS THE AUTHORIZATION TO ISSUE STATE GUARANTEED BONDS AND NOTES TO MAKE LOW INTEREST, TAX EXEMPT, LOANS TO COMPANIES FOR THE CREATION OF JOBS. LOANS CAN BE USED FOR 40% OF THE PROJECT CONSTRUCTION COST, AND CAN BE SPENT ON CONSTRUCTION, ACQUISITION, REHABILITATION, OR IMPROVEMENT OF INDUSTRIAL PLANTS OR OTHER ELIGIBLE FACILITIES. MACHINERY AND EQUIPMENT MAY ALSO BE PURCHASED WHEN APPROPRIATE WITH JDA FUNDS. PRIORITY FOR FUNDING IS GENERALLY TO FIRMS WHICH CANNOT OBTAIN ADDITIONAL CONVENTIONAL FINANCING FOR THE ENTIRE COST OF THE PROPOSED PROJECT.

THE FOLLOWING CRITERIA ARE USED TO ASSESS A JDA LOAN APPLICATION:

(1) CONSTRUCTION COMMITMENTS FOR OTHER ELEMENTS OF THE FINANCING PACKAGE.

(2) FIRMS ABILITY TO REPAY.

(3) THE NUMBER OF JOBS TO BE CREATED AND THE COST PER JOB.

(4) THE COMPANY'S NEED FOR THE LOAN.

(5) UNEMPLOYMENT RATES IN THE AREA.

(6) TIE-IN WITH OTHER PUBLIC SECTOR ECONOMIC ASSISTANCE PROGRAMS.

(7) CONFORMITY WITH NEW YORK STATE AFFIRMATIVE ACTION OBJECTIVES.

(8) CONFORMITY WITH LOCAL AREA DEVELOPMENT PLANS.

(9) CONTRIBUTION TO STATE'S GROWTH INDUSTRIES (i.e., HIGH TECHNOLOGY, ENERGY DEVELOPMENT, EXPORT RELATED, etc.)

(10) LABOR INTENSIVENESS OF FIRM.

STATEWIDE, OVER 90,000 EMPLOYEES ARE WORKING IN 1,000 FIRMS WHICH WERE SUPPORTED BY JDA FINANCING. THESE JOBS PRODUCE $70 MILLION A YEAR IN STATE AND LOCAL TAX REVENUE AND ALSO GENERATE ADDITIONAL FEDERAL INCOME TAX REVENUE. THE JDA LOAN OF $183 MILLION HAS PRODUCED $560 MILLION IN RELATED PRIVATE SECTOR INVESTMENT.

SUFFOLK COUNTY BUSINESSES HAVE BEEN A MAJOR RECIPIENT OF THE $183 MILLION LOANED BY THE JDA AS SECOND MORTGAGE FINANCING. OF ALL LOANS MADE, 35% HAVE BEEN PLACED IN THE BI-COUNTY AREA; 276 LOANS HAVE BEEN MADE TO SUFFOLK COUNTY FIRMS. THIS HAS LEVERAGED $50 MILLION IN LOANS INTO $149 MILLION TOTAL FOR NEW PLANTS AND EQUIPMENT. NOT ONE DOLLAR OF PUBLIC MONEY HAS BEEN USED. THIS LOW-INTEREST FUNDING MECHANISM IS VITAL TO THE CONTINUED GROWTH OF THE SMALL, YOUNG FIRMS WHICH MAKE UP A LARGE PART OF THE LONG ISLAND BUSINESS COMMUNITY. IN NOVEMBER 1981, NEW YORK STATE WILL HAVE THE

OPPORTUNITY TO VOTE FOR AMENDMENT #1 ON THE BALLOT; WHICH WILL AUTHORIZE THE SALE OF AN ADDITIONAL $150 MILLION IN TAX-EXEMPT BONDS, ENABLING THE JDA TO CONTINUE ITS VITAL PROGRAM.

FINANCIAL IMPACT OF IDBs.

ONE OF THE MAJOR CRITICS OF IDBs HAS BEEN THE U.S. TREASURY DEPARTMENT. THE TREASURY DEPARTMENT HAS STATED THAT THEY BELIEVE IDBs; WILL COST THE FEDERAL GOVERNMENT $1 BILLION IN LOST TAX REVENUE IN 1981. I AM NOT GOING TO DISPUTE THIS FIGURE, BUT I WOULD LIKE TO POINT OUT THAT IDBs HAVE A POSITIVE IMPACT UPON THE GROWTH OF OTHER REVENUE SOURCES AT THE LOCAL, STATE AND FEDERAL LEVEL.

AS STATED PREVIOUSLY, THE OPERATING IDAs IN SUFFOLK COUNTY AUTHORIZED $80,000,000 IN BONDS DURING THE PAST 18 MONTHS. THE AVERAGE INTEREST PAYABLE ON THESE IDBs WAS 10%. IF THE COMPANIES HAD USED CONVENTIONAL FINANCING, THE AVERAGE INTEREST WOULD HAVE BEEN 20%. THEREFORE, THE FEDERAL GOVERNMENT LOST INTEREST ON APPROXIMATELY $8 MILLION. SINCE THE MAXIMUM TAX RATE IS 50%, THIS REPRESENTS A $4 MILLION LOSS FOR THE TREASURY.

ASSUMING ONLY THE NEW JOBS CREATED (2,574), AT AN ANNUAL SALARY OF $15,400 PER JOB (AVERAGE WEEKLY EARNINGS FOR ALL FACTORY PRODUCTION WORKERS IN THE NASSAU/SUFFOLK AREA) AND ASSUMING A TAX BRACKET OF 32%, THE TOTAL INCOME TAXES REALIZED BY THE FEDERAL GOVERNMENT FROM THESE NEWLY CREATED JOBS WOULD EXCEED $12 MILLION. THIS REPRESENTS A NET GAIN, NOT LOSS, TO THE FEDERAL GOVERNMENT OF $8 MILLION .

LOCAL AND STATE GOVERNMENTS ALSO SHOW REVENUE GAINS FROM IDB FINANCING, PRIMARILY BECAUSE OF NEW PROPERTY TAX ASSESSMENTS, INCREASED SALES TAX REVENUE AND INCREASED STATE INCOME TAX REVENUE. IT IS ESTIMATED THAT SUFFOLK COUNTY, DURING THE PAST TWO-YEAR PERIOD, HAS GAINED ALMOST $2 MILLION IN NEW PROPERTY TAXES.

CURRENT STATUS OF INDUSTRIAL DEVELOPMENT AGENCY LEGISLATION

New York State

IN NEW YORK STATE, THE CONTINUED USE OF INDUSTRIAL DEVELOPMENT BONDS AND THE CREATION OF NEW IDAs, HAS COME UNDER STATE LEGISLATIVE REVIEW. ASSEMBLYMAN DENNIS T. GORSKI (D-146), CHAIRMAN OF THE ASSEMBLY COMMITTEE ON OVERSIGHT, ANALYSIS AND INVESTIGATION, HAS COMPLETED A REPORT ENTITLED, "NEW YORK STATE INDUSTRIAL DEVELOPMENT AGENCIES: THE OBJECTIVES IN 1969-THE REALITY OF 1981". THIS REPORT, WHICH I PREVIOUSLY CITED FROM, IS SOMEWHAT CRITICAL OF THE WAY IDA BONDS HAVE BEEN USED IN NEW YORK STATE. THE ASSEMBLYMAN HAS RECOMMENDED THAT THE NEW YORK STATE LEGISLATURE PASS MORE STRINGENT STATE LEGISLATION THAT WOULD CLARIFY WHAT IDA FUNDING CAN BE USED FOR WITHIN THE STATE. SOME OF HIS PROPOSED CHANGES INCLUDE:

1- CLARIFICATION OF WHAT CONSTITUTES AN ACCEPTABLE IDA PROJECT AND RESTRICTIONS ON THE USE OF IDBs FOR COMMERCIAL PURPOSES.

2- A BETTER MECHANISM TO CONTROL INTRASTATE "PIRATING" AND REQUIRE CLOSER EXAMINATION OF EACH PROJECT FOR TAX BENEFIT/DETRIMENT FIGURES AND COMMITMENT TO REGIONAL GOALS.

3- A REQUIREMENT FOR YEARLY REPORTING TO THE NEW YORK STATE DEPARTMENT OF COMMERCE.

4- INSURE THAT NO NEW IDAs ARE CREATED WITHIN NEW YORK STATE.

THE PROPOSED CHANGES APPEAR TO BE REASONABLE, AND WOULD MOST LIKELY HAVE A POSITIVE IMPACT UPON THE USE OF IDBs. I AM SORRY TO SAY, HOWEVER, THAT SOME OF THE CHANGES BEING PROPOSED AT THE FEDERAL LEVEL ARE NOT AS BENEFICIAL.

U.S.House Of Representatives

H.R. 4420 INTRODUCED SEPTEMBER 9, 1981, BY REPRESENTATIVE CHARLES RANGEL (D-N.Y.) CONTAINS A NUMBER OF CHANGES TO THE FEDERAL LAW GOVERNING THE USE OF IDBs. I WOULD LIKE TO MAKE THE FOLLOWING COMMENTS ON THE PROPOSED CHANGES:

(1) Limitation On Commercial Use Of IDBs

EVEN THOUGH SUFFOLK COUNTY'S IDA HAS NEVER AUTHORIZED A COMMERCIAL PROJECT I BELIEVE THAT IN SOME INSTANCES A NEED TO FUND A COMMERCIAL PROJECT MIGHT EXIST. WITHIN SUFFOLK COUNTY ARE A NUMBER OF LOW-INCOME COMMUNITIES, WHICH MIGHT SUBSTANTIALLY BENEFIT FROM THE CONSTRUCTION OF A NEW COMMERCIAL PROJECT. REVITALIZATION OF OUR OLDER, DOWNTOWN AREAS, IS A MAJOR ACTIVITY UNDER OUR EXISTING COMMUNITY DEVELOPMENT PROGRAM.

I WOULD SUPPORT SOME LIMITATION ON COMMERCIAL IDBs. I DO NOT FEEL, HOWEVER, THAT THEY SHOULD ONLY BE LIMITED TO URBAN DEVELOPMENT ACTION GRANT (UDAG) AREAS. THE CRITERIA FOR UDAG ARE EXTREMELY RESTRICTIVE. IN FACT, IN ALL OF SUFFOLK COUNTY, THERE ARE ONLY THREE SMALL AREAS WHICH QUALIFY FOR UDAG GRANTS. I WOULD RATHER SEE LEGISLATION WRITTEN THAT WOULD GIVE THE CHIEF ELECTED COUNTY OR CITY OFFICIAL THE ABILITY TO ESTABLISH, BASED ON LOCAL NEEDS, TWO TO THREE AREAS WITHIN THE JURISDICTION WHERE COMMERCIAL IDBs COULD BE AUTHORIZED.

(2) Yearly Report

REQUIRING THAT A YEARLY SUMMARY OF ALL THE ACTIVITIES OF IDAs WITHIN A STATE BE SUBMITTED TO THE U.S. TREASURY DEPARTMENT, WOULD BE, I BELIEVE, A POSITIVE MECHANISM FOR OBTAINING INFORMATION ON THE EXTENT OF IDB ACTIVITIES WITHIN THE COUNTRY. IN THE NEW YORK STATE ASSEMBLY DURING THE PAST SESSION A BILL TO REQUIRE YEARLY REPORTS WAS INTRODUCED. SUFFOLK COUNTY IDA ALREADY PREPARES SUCH AN ANNUAL REPORT ON ITS ACTIVITIES.

(3) Public Hearing Requirement

IN SUFFOLK COUNTY ALL MEETINGS OF THE IDA BOARD ARE ALREADY OPEN TO THE PUBLIC. REPRESENTATIVES OF THE LOCAL MEDIA ARE ADVISED OF THE MEETING AND USUALLY ATTEND. I FEEL THAT A RIGID PUBLIC HEARING REQUIREMENT WOULD ONLY BE COSTLY, BURDENSOME AND TIME CONSUMING. HOWEVER, I BELIEVE THAT A REQUIREMENT THAT A NOTICE BE PUBLISHED IN A LOCAL PAPER TEN (10) TO FIFTEEN (15) DAYS PRIOR TO THE MEETING, INDICATING WHAT APPLICATIONS ARE BEING CONSIDERED AND THE DATE/TIME OF THE MEETING, WOULD NOT BE UNDULY BURDENSOME.

(4) Sunset Provision

I FEEL THAT HAVING A MANDATORY REVIEW AND REPORT PREPARED BY THE U.S. TREASURY DEPARTMENT ON IDBs BY 1984 WOULD BE A WORTHWHILE ENDEAVOR. I WOULD LIKE TO RECOMMEND HOWEVER THAT IDBs CONTINUE TO EXIST UNLESS CONGRESS TAKES POSITIVE ACTION TO REVISE OR DISCONTINUE; RATHER THAN CALLING FOR THEIR AUTOMATIC TERMINATION IN 1984, UNLESS RENEWAL LEGISLATION IS PASSED. I ALSO BELIEVE THAT INSTEAD OF THE TREASURY DEPARTMENT BEING GIVEN THE SOLE MANDATE TO STUDY IDBs, THAT THE SMALL BUSINESS ADMINISTRATION, THE DEPARTMENT OF COMMERCE AND THE DEPARTMENT OF LABOR SHOULD ALSO PARTICIPATE IN THE STUDY. AFTER ALL, IDBs AFFECT A VAST ARRAY OF BUSINESSES AND HAVE A DIRECT IMPACT UPON EMPLOYMENT, THEREFORE, I BELIEVE THAT OPINIONS FROM A DIVERSE TEAM OF EXPERTS SHOULD BE CONSIDERED WHILE PREPARING THE REPORT.

EFFECT OF RECENT U.S. TREASURY DEPARTMENT RULING 81-216

ON AUGUST 24, 1981, THE U.S. TREASURY DEPARTMENT ISSUED REVENUE RULING 81-216. THIS RULE TOOK EFFECT IMMEDIATELY AND WAS NOT SUBJECT TO A REVIEW OR COMMENT PERIOD BY AFFECTED PARTIES. THIS RULING HAS THROWN THE INDUSTRIAL DEVELOPMENT BONDING MARKET INTO A STATE OF DISARRAY. FIRST, BECAUSE THE RULING REVERSED A NUMBER OF RECENT LETTER DECISIONS GIVEN TO IDAs AND OTHER STATE FUNDING AUTHORITIES; AND, SECONDLY, SINCE IT TOOK EFFECT IMMEDIATELY, IT STOPPED A NUMBER OF BONDING TRANSACTIONS WHICH WERE ALREADY UNDER WAY.

RULING 81-126 HAD FOUR MAJOR THRUSTS:

(1) IT OVERTURNED A PRIOR TREASURY DECISION THAT SMALL ISSUE IDBs COULD BE AGGREGATED INTO LARGER ISSUES, SOLD AS A PACKAGE, AND STILL RETAIN THEIR TAX EXEMPT STATUS.

(2) IT DISALLOWED THE PRACTICE WHEREBY SEPARATE IDAs COULD AUTHORIZE ONE PART OF A LARGER BOND ISSUE FOR A COMPANY WISHING TO ESTABLISH MULTIPLE LOCATIONS AROUND A STATE OR REGION.

(3) IT DISALLOWED THE POOLING OF IDBs INTO WHAT HAS BEEN TERMED A MUNICIPAL INVESTMENT TRUST.

(4) IT DISALLOWED THE PRACTICE OF BACKING IDBs WITH OTHER FEDERAL OR STATE LOAN GUARANTEES.

THE IMMEDIATE EFFECT OF THE RULING HAS BEEN TO CHILL THE IDB MARKET. THE LONG TERM EFFECT WILL BE TO INCREASE THE ADMINISTRATIVE COST TO AGENCIES, SUCH AS THE NEW YORK STATE J.D.A.; WHICH FORMERLY WAS ABLE TO ACHIEVE SOME MEASURE OF ADMINISTRATIVE EFFICIENCY BY AGGREGATING IDBs AND THEREBY CUTTING DOWN ON PAPERWORK, PROCESSING FEES, AND ISSUING COSTS.

THE SUBTLE BEHIND-THE-SCENES EFFECT OF THIS RULING AND OTHER RECENT ACTIONS ON THE PART OF THE REAGAN ADMINISTRATION, HOWEVER, HAS BEEN TO START A MULTITUDE OF RUMORS CIRCULATING ABOUT THE FUTURE OF IDBs. THERE IS ALREADY GROWING APPREHENSION THAT RULING 81-216 OF THE U.S. TREASURY DEPARTMENT IS JUST THE FIRST AND THAT OTHERS, FURTHER LIMITING THE USE OF IDBs, WILL BE FORTHCOMING.

THERE IS ALSO A PERSISTENT RUMOR THAT AN ADMINISTRATION BILL WILL SHORTLY BE INTRODUCED INTO CONGRESS, CALLING FOR AN IMMEDIATE HALT TO IDB FINANCING. A BILL SIMILAR TO THE ONE ORIGINALLY PROPOSED FOR MORTGAGE REVENUE BONDS, WHICH CALLED FOR MORTGAGE REVENUE BONDS TO END EFFECTIVE THE DAY THE BILL WAS INTRODUCED. IF SUCH A BILL IS INTRODUCED, IT WILL KILL ALL ACTION ON IDBs. NO-ONE WILL BE WILLING TO TAKE THE TIME AND EFFORT TO PROCESS AN IDB WHEN IT APPEARS THAT THE ENTIRE FUNDING MECHANISM WILL BE RETROACTIVELY ABOLISHED.

I WOULD LIKE TO URGE THAT SOME POSITIVE STEPS BE TAKEN TO QUELL THE RUMORS CIRCULATING AND TO DEAL WITH THE IDB MATTER IN A MANNER WHICH WILL ALLOW FOR OPEN DISCUSSION OF THE ISSUE, AND ADEQUATE LEGISLATIVE CONSIDERATION.

IN A PRESS RELEASE ISSUED ON OCTOBER 1, 1981, THE INTERNAL REVENUE SERVICE STATED THAT THEY WILL BE ISSUING A NEW PROPOSED REGULATION ON OCTOBER 5, 1981 IN THE FEDERAL REGISTER, RESTATING RULING 81-216. ACCORDING TO THE INFORMATION I HAVE RECEIVED, HOWEVER, THE NEW PROPOSED REGULATION WILL STILL BE RETROACTIVE TO AUGUST 24, 1981. THEREFORE, IN FORM THIS APPEARS TO ALLOW FOR COMMENT, BUT IN REALITY, THE POLICY SEEMS TO HAVE ALREADY BEEN MADE. I WOULD HOPE THAT THIS COMMITTEE WILL DIRECT THAT AN IN-DEPTH REVIEW OF THE RECENT U.S. TREASURY DEPARTMENT RULING (81-216) TO ASSESS WHETHER IT REALLY WILL BE EFFECTIVE OR WHETHER IT WON'T SIMPLY RAISE ADMINISTRATIVE OVERHEAD COSTS FOR THE PROCESSING OF IDBs.

CONCLUSION

I FIRMLY BELIEVE THAT IDBs HAVE HAD A POSITIVE IMPACT UPON THE LOCAL ECONOMY.

THE AVAILABILITY OF IDB FINANCING HAS ACCOUNTED FOR SUBSTANTIAL MAJOR NEW INDUSTRIAL CONSTRUCTION AND BUSINESS EXPANSION IN SUFFOLK COUNTY. IT IS MY BELIEF THAT THE MAJORITY OF THE NEW INDUSTRIAL EXPANSION OCCURING WITHIN SUFFOLK WOULD NOT OTHERWISE HAVE OCCURRED WITHOUT THE EXISTENCE OF THE IDB FUNDING MECHANISM.

IF REFORM IS NEEDED, THAN LET'S MAKE THE REFORMS IN A POSITIVE FASHION. THERE HAS BEEN A MOVE DURING THE REAGAN ADMINISTRATION TO RETURN POWER TO THE STATES. I BELIEVE THAT AS A PART OF THIS TREND, THE MAJORITY OF REGULATIONS GOVERNING THE USE OF IDBs SHOULD BE LEFT TO THE STATES TO ENACT. THE STATES SHOULD HAVE A ROLE IN REGULATING THEIR INTERNAL AFFAIRS. I DO NOT BELIEVE THAT ANY NEW EXCESSIVE FEDERAL REGULATION IS NEEDED IN THIS AREA.

I BELIEVE THAT IF ANY NEW FEDERAL LEGISLATION IS ENACTED IT SHOULD DEAL SOLELY WITH SETTING RESTRICTIONS ON THE USE OF IDBs WHICH WOULD ELIMINATE MAJOR ABUSES, YET LEAVE THE INDIVIDUAL STATES FREE TO GOVERN THE DAY-TO-DAY ADMINISTRATION OF THE PROGRAM AND TO ADAPT THE PROGRAM TO REGIONAL AND INTRA-STATE NEEDS.

UNTIL INTEREST RATES START TO RETURN TO A REASONABLE AND REALISTIC LEVEL, IDBs ARE THE ONLY FINANCING MECHANISM WHICH CAN BE USED TO STIMULATE LOCAL DEVELOPMENT AND PRODUCTION, AND TO CREATE NEW JOBS.

APPENDIX A

The following excerpts were taken from letters received from IDA Assisted Companies

"IT IS OUR CONTENTION THAT THE AVAILABILITY OF THE TAX-EXEMPT REVENUE BONDS IS A VIABLE SOURCE OF GROWTH AND EXPANSION FOR BUSINESS AND DOES RESULT IN POSITIVE JOB GENERATION."

Standford A. Mebus
Regional Finance Officer
Kollmorgan Corporation

"WE TRUST THAT THE SUBSTANTIAL INCREASE IN OUR PAYROLL DURING THE PAST YEAR, AS WELL AS THE MAJOR INCREMENT EXPECTED DURING THE NEXT TWELVE MONTHS, WILL CLEARLY SUPPORT THE BENEFIT THAT WE, AND THE COMMUNITY, HAVE REALIZED FROM THE PROGRAM YOU ADMINISTER."

S. Okwit
President
LNR Communications, Inc.

"OFTEN WHEN A COMPANY IS FACED WITH AN EXPANSION PROBLEM, THE ULTIMATE DECISION WILL INVARIABLY REST WITH THE ECONOMICS OF THE OPTIONS AVAILABLE. AS A RESULT, IN ADDITION TO THE POSSIBILITY OF PROVIDING NEW JOBS, IT ALSO PREVENTS THE LOSS OF EXISTING JOBS SHOULD THE DETERMINATION BE MADE TO MOVE OUT OF STATE."

"VICON CONSIDERED THE EFFECT OF THE INDUSTRIAL REVENUE BONDS THE KEY FACTOR IN ITS DECISION TO ACQUIRE THE BABYLON FACILITY."

Kenneth Darby
Treasurer
Vicon Industries, Inc.

"WE ADDED APPROXIMATELY 30,000 SQUARE FEET TO OUR PRODUCTION FACILITY AND 12,000 SQUARE FEET OF OFFICES. SIGNIFICANTLY, ALL OF THE PRODUCTION SPACE IS DEDICATED TOWARDS THE DEVELOPMENT OF NEW BUSINESS AND THE OFFICE SPACE TO ENABLE US TO DEVELOP AND EXPAND OUR CORPORATE FACILITIES. WE WOULD BE MOST PLEASED TO HAVE YOU VISIT OUR FACILITY TO FULLY COMPREHEND THE DEPTH OF OUR EXPANSION, ALL OF WHICH COULD NOT HAVE TAKEN PLACE WITHOUT AUTHORITY FINANCING."

Steven Hill
Vice President - Finance
Southern Container Corporation

"THE FINANCIAL ASSISTANCE PROVIDED BY YOUR AGENCY HAS BEEN INVALUABLE IN OBTAINING OUR CURRENT AND PROJECT LEVELS OF GROWTH IN SUFFOLK COUNTY."

Walter Thompson
Manager, Administration
Target Rock Corporation

TESTIMONY

OF

EDWARD J. RUTKOWSKI

COUNTY EXECUTIVE

COUNTY OF ERIE, NEW YORK

I COULD BEGIN MY REMARKS WITH A LITANY OF STATISTICS -- THE KIND WITH WHICH YOU ARE ALL TOO FAMILIAR -- ABOUT THE ECONOMY OF ERIE COUNTY, THE SECOND LARGEST URBAN AREA IN NEW YORK STATE. THE NUMBERS WOULD TELL OF A ONCE THRIVING INDUSTRIAL ECONOMY WHICH HAS SEEN NEARLY 100 FACTORY CLOSINGS OR CUTBACKS IN THE PAST DECADE AND A LOSS OF MORE THAN 30,000 MANUFACTURING JOBS. THEY WOULD ALSO TELL OF CONTINUING HIGH UNEMPLOYMENT, CURRENTLY AT 10%, AND CONTINUING EROSION OF THE BASIC HEAVY INDUSTRIES WHICH ONCE FUELED THE ECONOMY OF BUFFALO AND ERIE COUNTY.

BUT I WOULD RATHER TELL YOU OF THE RECOVERY THAT WE HAVE BEGUN, OF THE FIRST STEPS WE HAVE TAKEN ON THE STILL LONG ROAD BACK TO ECONOMIC HEALTH. ABOVE ALL, I WOULD LIKE TO TELL YOU WHAT HAS MADE THOSE STEPS POSSIBLE BECAUSE I HAVE COME HERE TODAY TO URGE YOU TO PRESERVE THE SMALL ISSUE INDUSTRIAL REVENUE BOND, ONE OF OUR MOST POWERFUL INSTRUMENTS FOR ACHIEVING THAT RECOVERY.

ERIE COUNTY'S LONG TERM ECONOMIC DECLINE ALWAYS ACCELERATED DURING PERIODS OF NATIONAL CYCLICAL SLOWDOWN. IT REACHED A PEAK IN AUGUST 1977 WHEN 3,000 STEELWORKERS LOST THEIR JOBS DUE TO A PERMANENT CURTAILMENT IN OPERATIONS BY A LOCAL STEEL PLANT. WE HAD JUST BEGUN A REORGANIZATION OF OUR COUNTY-WIDE ECONOMIC DEVELOPMENT ACTIVITIES. THIS MASSIVE LAYOFF ONLY SERVED TO FOCUS OUR EFFORTS ON THE DEVELOPMENT OF A LONG TERM STRATEGY FOR RECOVERY.

WITH AN EDA TITLE IX ECONOMIC DEVELOPMENT PLANNING GRANT, WE UNDERTOOK AN EXHAUSTIVE SERIES OF STUDIES AND ANALYSES TO PRODUCE THE BUFFALO AREA ECONOMIC ADJUSTMENT STRATEGY. THIS IS OUR "ECONOMIC

Blueprint" for creating 8,000 jobs and achieving a shift in our economic base from heavy industry to diverse light and medium manufacturing and service industries. We identified those industries that held the greatest potential for our economy, based upon both national growth trends and a match between industrial requirements and regional assets. And then we established six programs for realizing that potential.

One of these six is a program of financial assistance, which provides incentives for expansion and retention of existing Erie County target industries, as well as inducement for new firms to locate in our area. Along with other Financial incentives, Industrial revenue bonds have been a key to our success in retaining or expanding firms in targeted industries. Between January 1979 and the end of September 1981 we issued 56 bonds, totalling $125 million and creating approximately 2500 new jobs. In 1979 and 1980, two-thirds of all bonds issued financed firms in targeted growth industries; an additional eleven percent were in industries identified for retention. Equally significant is the fact that over 85% of the companies receiving assistance through these bond issues were small businesses.

All of us involved in economic development have come to realize that it is primarily to small business that we must look for our economic future. Our experience has borne out the fact that they are the greatest source of economic growth and job expansion, accounting for up to 85% of the Nation's new jobs in the private sector.

YET THE MEASURES ADOPTED IN THE ECONOMIC RECOVERY ACT OF 1981, IMPORTANT AS THEY ARE FOR PROMOTING REAL GROWTH IN OUR NATIONAL ECONOMY, PROMISE LITTLE FOR SMALL FIRMS IN CAPITAL-HUNGRY STAGES OF GROWTH. TO THESE TAX RELIEF IS AT BEST A FUTURE PROMISE, NOT A CURRENT RESOURCE; THE TAX CUT AND BUSINESS TAX REFORM PROPOSALS ARE NO SUBSTITUTE FOR INDUSTRIAL REVENUE BONDS AND OTHER DIRECT AND INDIRECT FEDERAL SUBSIDIES. BY REDUCING THE COST OF CAPITAL AND PROVIDING OTHER CLEARLY IDENTIFIABLE SAVINGS, TAX-EXEMPT IRB'S PROVIDE A "CERTAINTY OF BENEFITS" WHICH MATERIALLY REDUCES THE RISK TO AN INVESTOR AND INCREASES THE PROBABILITY OF SUCCESS FOR THE VENTURE. BY CONTRAST, TAX-BASED INCENTIVES ARE MOST EFFECTIVE IN MORE MATURE STAGES OF A BUSINESS WHEN PROFITABILITY IS ASSURED. THEREFORE THEY HAVE LESS INFLUENCE IN INVESTMENT DECISIONS FOR HIGH RISK PROJECTS, THE TYPICAL SMALL BUSINESS EXPANSION.

WE RECOGNIZE THAT THE GROWTH IN TAX EXEMPT ISSUES REPRESENTS A PROBLEM FOR OUR NATIONAL BUDGET. WE ALSO RECOGNIZE THAT IN MANY INSTANCES THESE BONDS ARE OFTEN MISUSED, ISSUED FOR PURPOSES OTHER THAN TO INDUCE BASIC ECONOMIC ACTIVITY.

IN ERIE COUNTY, THROUGH 1980, WE ISSUED ONLY ONE COMMERCIAL REVENUE BOND; THIS YEAR WE ARE INVOLVED IN FOUR ADDITIONAL ISSUES, EACH OF WHICH WILL FINANCE AN ESSENTIAL COMPONENT OF THE CITY OF BUFFALO'S DOWNTOWN REVITALIZATION PROGRAM. THEY ARE IN URBAN RENEWAL AREAS AND ARE GENERALLY ACCOMPANIED BY URBAN DEVELOPMENT ACTION GRANTS.

I BELIEVE OUR PROGRAM IS EXEMPLARY IN RESTRICTING THE USE

OF THE BOND TO BASIC INDUSTRIES AND TO COMMERCIAL PROJECTS WHICH SET IN MOTION MAJOR REDEVELOPMENT OF DISTRESSED AREAS. OUR MAJOR AND UNIVERSALLY APPLIED STANDARD, IN ADDITION TO NET NEW JOBS CREATED, IS: CAN THIS PROJECT OCCUR WITHOUT THE BOND. BONDS ARE NOT ISSUED IN ERIE COUNTY IF THE ANSWER IS YES.

WE URGE YOU TO RECOGNIZE THE UNIQUE EFFECTIVENESS OF THE SMALL ISSUE IN PROMOTING THE SMALL BUSINESS INVESTMENT SO VITAL TO ERIE COUNTY AND OTHER AREAS ATTEMPTING TO RECOVER FROM ECONOMIC DECLINE.

TO ELIMINATE ABUSE, LIMIT THEIR GROWTH AND EXCESSIVE COSTS TO THE TREASURY, WE URGE THAT IRB'S BE TARGETED TOWARD DISTRESSED AREAS AND THAT STRINGENT RESTRICTIONS BE PLACED ON THE USE OF IRB'S FOR COMMERCIAL PROJECTS. IN CONJUNCTION WITH TARGETING AND RESTRICTED COMMERCIAL USES, WE RECOMMEND THAT THE MAXIMUM TAX-EXEMPT LIMIT AND CAPITAL EXPENDITURE LIMIT BE ADJUSTED UNDER CERTAIN CIRCUMSTANCES.

WHILE SUCH CHANGES CAN TAKE MANY FORMS, THE FOLLOWING ILLUSTRATES ONE SET OF ALTERNATIVES TO CONSIDER:

1. IN GENERAL, RESTRICT SMALL ISSUE INDUSTRIAL REVENUE BONDS TO INDUSTRIAL USES, INCLUDING WAREHOUSING AND DISTRIBUTION.
2. AGAIN IN GENERAL, RETAIN THE CURRENT CAPITAL EXPENDITURE LIMITATION, AND REDUCE THE MAXIMUM TAX-EXEMPT ISSUE AMOUNT TO $5 MILLION. THIS WILL REINFORCE SMALL BUSINESS CAPITAL FORMATION BENEFITS, BUT LIMIT THE USEFULNESS OF SMALL ISSUES FOR BRANCH OPERATIONS OF LARGE FIRMS.

3. DESIGNATE TARGET AREAS (SMSA'S) ON THE BASIS OF SUBSTANTIAL AND PERSISTENT UNEMPLOYMENT, WHERE CAPITAL EXPENDITURE LIMITATIONS WOULD BE WAIVED AND THE MAXIMUM TAX-EXEMPT ISSUE INCREASED TO $20 MILLION.

4. PERMIT COMMERCIAL REVENUE BOND PROJECTS ONLY WITHIN THESE DESIGNATED TARGET AREAS, AND ONLY IF SUCH PROJECTS ARE INTEGRAL AND NECESSARY TO A FEDERALLY SPONSORED REDEVELOPMENT PROGRAM.

5. IF URBAN ENTERPRISE OR JOB CREATION ZONE LEGISLATION IS ENACTED FOR HIGHLY TARGETED, DISTRESSED, INNER-CITY AREAS, ALL CAPITAL EXPENDITURE AND MAXIMUM TAX-EXEMPT ISSUE LIMITS SHOULD BE WAIVED IN THESE ZONES.

I AM CONFIDENT THAT BUFFALO AND ERIE COUNTY WILL BE RESTORED TO AN ECONOMIC STRENGTH EQUAL TO THAT OF OUR DAYS AS A VIBRANT CENTER OF INDUSTRY. WE HAVE ACHIEVED A REMARKABLE AND UNPRECEDENTED COOPERATION AND UNITY IN OUR DETERMINATION TO REALIZE OUR GOAL. BUT WE WOULD BE SEVERELY AND PERHAPS INSURMOUNTABLY HAMPERED IN OUR EFFORTS WITHOUT THE USE OF THE SMALL ISSUE TAX EXEMPT BONDS.

Senator D'AMATO. I would like to advise those who are waiting to hear Governor Snelling that he will be here at 11:30 to make his testimony. Governor Snelling is also chairman of the National Governors Association.

We will continue with our next panel:

Mr. Robert Smith, Mr. Kenneth Schuman, Deborah Ferolito, Mr. Hank Auffarth, and the Honorable Tim Donovan from the State of Illinois.

Mr. Smith, will you please proceed?

STATEMENT OF ROBERT J. SMITH, PRESIDENT, SMITH BROTHERS INSURANCE, INC., SOUTH WINDSOR, CONN.

Mr. SMITH. Thank you.

My name is Robert J. Smith. I am the president of Smith Bros. Insurance, Inc., located at 5 Oakland Road in South Windsor, Conn. We are a multiple line independent insurance agency.

In 1961, I started my business by taking a loan from an insurance company. At that time, I had two children with no other source of income.

Approximately 12 years ago, my brother Brian and I merged our resources and formulated the presently existing entity.

My background and experiences with numerous activities, along with working closely with small business entrepreneurs, are as a former aide to Congressman William R. Cotter and as a councilman, deputy mayor, and mayor, totaling 6 years in South Windsor. I have had the experience of both being on the elected side, as well as the business side.

Senator DIXON. I knew Congressman Cotter. He is a fine man. I know we all regret his passing.

Mr. SMITH. He certainly was.

I served on advisory boards for a bank, a hospital, and a church. I was a delegate to the White House Conference on Small Business.

I have been a member of the Small Business Administration administrator's National Advisory Council, and I have been a member of the Small Business Administration Regional Advisory Council.

My interest in testifying today is solely for the betterment of the small business economic climate. I have never received any compensation for packaging loans.

Certainly as a small businessman doing business on a regular basis with other small entities which have available to them proper long-term financing, my agency would certainly benefit indirectly.

The recent Revenue Ruling 81-216 prohibiting the issuance of multiple lots of $1 million tax-exempt industrial development bonds is devastating to small business entrepreneurs.

At the White House Conference on Small Business, attended by over 1,500 small business persons throughout the country, the message clearly stated frequently was that Government regulatory agencies should study economic impact on small businesses before enacting or eliminating regulations.

I am not an expert on tax-exempt industrial development bonds, but I can give you very specific examples of the impact these bonds have had, or will have, on small business in Connecticut.

Murray Gerber, president of Prototype and Plastic Mold Co. from Middletown, Conn., constructed a 18,000 square foot plant that he would not have been able to build without the use of Connecticut economic development tax-exempt bonds.

After 1 year, Murray has hired an additional 20 employees and financed $180,000 in machinery. Presently, he is planning to expand his plant to house additional computerized equipment valued at $500,000. The expansion will not occur without tax-exempt bonds, because the numbers do not work if the financing is prime plus 1½ percent.

The Harford Faince Co. in Hartford, Conn., employs over 125 minorities and first generation immigrants. They are semiskilled employees manufacturing porcelain electrical insulators. The company needs more space for updated machinery so they can continue to be a viable operation and maintain their sales growth.

Mr. Gerald McGrath, the general manager and treasurer, indicates that his company will not expand if the interest rates remain at the present high level and the tax-exempt bonds become unavailable.

Bernie and Vic Zionts from Bervic Co. in Bloomfield, Conn., were contemplating more expansion to house their growing inventory. Bernie and Vic started the business after serving in World War II in the Navy. They are in the retirement range with the second generation now at the middle management level. Their business, and the continued success of it, will be their retirement program.

David and Dennis Silva, Dari Farms Ice Cream Co., Inc., Tolland, Conn., are two under 30-year-old entrepreneurs who work 6 days and nights per week building a fast-growing ice cream and yogurt distributorship. They sell their products and ship them in their own vehicles as far west as California and as far south as Florida.

They had to curtail their expansion recently and instead borrowed only $60,000 at prime rates to construct an asphalt parking area.

Because of high interest rates, their accounts receivables are growing. Large-size companies are delaying payments, choosing either to short-term invest the money or to use it to carry their own receivables.

Barbour & Barbour Associates, Inc. was established by Barbara Barbour in 1977 in the basement of her home in Enfield, Conn. The company began as a graphics shop and subcontracted printing to other printing shops.

B. & B.'s reputation for high quality work was quickly established throughout the business community. Today they are a full-service printing operation with over 85 employees and annual sales exceeding $5 million. However, something happened on the way to this success story.

B. & B.'s billing terms were net 10 days, while paying its printing bills in net 30 days. Therefore, they always had plenty of cash in the bank. The marketplace changed. Paper, the largest cost item, was in short supply. Therefore, they were forced to carry 6 months' supply of inventory to be certain they had the needed amount. The paper prices became inflated, and they had storage problems.

Most of these problems have been turned around due to good management and skillful work in the marketplace. However, they are now working at full capacity, 24 hours a day. There is presently no press time available.

Unless they can expand their facilities and continue the consistent upward pattern enjoyed since their inception, they will become stagnant and larger companies will eventually take over many of their customers.

The success of these companies is the reason why Connecticut enjoys an unemployment record significantly below the national average. Manufacturing employment rose by 52,000 from 1975 to 1980. The rippling effects of the tax-exempt industrial revenue bonds is a major side benefit to all of us.

A lower debt service permits more funds available to purchase machinery, creating more manufacturing jobs.

The availability of tax-exempt IDB's would not only assist a company financially but the various other governmental agencies are plugged in, such as OSHA and SBA, to assure success of the company and be certain loans are repaid.

It has been said that the Connecticut Development Authority could be a model for the rest of the country. Over 500 companies have used the program successfully.

If the broader question on tax-exempt IDB's is to be answered, we need time to study the impact on such companies that I have mentioned here today.

I urge you to support Senate bill 1635—a bill to delay the application of Revenue Ruling 81-216 until January 3, 1983.

Thank you.

Senator D'AMATO. Thank you very much, Mr. Smith.

Mr. Schuman?

I would like to ask the panel, when Governor Snelling and Senator Stafford arrive, if we could briefly give them the opportunity to testify.

STATEMENT OF KENNETH S. SCHUMAN, COMMISSIONER, NEW YORK CITY OFFICE OF ECONOMIC DEVELOPMENT

Mr. SCHUMAN. Thank you, Mr. Chairman, for allowing me to testify.

I am commissioner for economic development of the city of New York.

I am just going to give you a summary of my testimony, but I would like my full statement to be read into the record as if it were delivered.

Senator D'AMATO. It is so ordered.

Mr. SCHUMAN. New York City supports the continuation of industrial revenue bond financing to assist in its local economic development efforts. The availability of this tool is necessary in the attempt to encourage small business exansion and retention.

Small business is the major source of employment in the city, as well as in the Nation, and that sector of the business community most in need of governmental incentive.

Industrial revenue bond financing in New York City is primarily geared toward assisting small business expansion and capital investment. The elimination of this important tool will create a severe setback in New York's economic development efforts.

New York City's jobless rate, according to the Bureau of Labor Statistics, has increased, while the neighboring States' unemployment rates have decreased.

The major problems experienced by industry operating in the city are high taxes, utility costs, and escalating real estate costs.

Between 1961 and 1975, the city lost over 300,000 manufacturing jobs, approximately one-third of which resulted from industrial migration to neighboring States.

Since 1975 and the creation of the IDA, this migration trend has been stemmed, although not reversed.

In 1980 alone, the city suffered a net decline of 20,000 manufacturing jobs.

IRB financing has proven to be a mitigating factor in the retention of certain industries in New York City. A good example is the printing industry, the city's second largest.

In the last decade, 264 printers relocated to areas outside New York City, resulting in the loss of over 3,000 jobs.

Since 1975, the New York City IDA has induced 14 printing companies to stay and expand their operations in New York City. These financings stimulated over $30 million in capital investment, retained 1,340 printing jobs, and created an additional 710 jobs.

The use of revenue bond financing to offset some inherent disadvantages of doing business in New York has made a major contribution to the reversal of the migration trend of printers to other States, as well as stimulated capital investment and job creation in the city.

Revenue bond financing has also helped to reverse declining economies of marginally distressed industrial communities.

In 1975, industrial space in Long Island City, Queens, averaged $1.50 to $2 per square foot, and there were many vacant facilities with severe real estate tax arrearages.

Today, after 41 industrial revenue bond financings, the price per square foot has doubled and most of the industrial facilities are productive, job creating, and tax-generating buildings.

Further, the development of marginally distressed areas of the city has significant impact upon the neighboring residential communities.

In an urban environment such as New York, where sophisticated mass transportation networks allow greater mobility of the labor pool, jobs created in industrial communities helped the economic growth of neighboring residential communities.

In conclusion, the use of IRB's to stimulate investment serves to strengthen New York City's economy by reducing unemployment, increasing the economic vitality of marginal and distressed communities, and by increasing the corporate, personal, and real estate tax base of the city.

Revenue bonds are a vital tool in the continued successful economic development of New York, and their use is still a necessary ingredient to the future health and vitality of the city.

Thank you very much for allowing me to testify.

Senator D'AMATO. Thank you.

Deputy Executive Director Deborah Ferolito of the Industrial Development Agency.

STATEMENT OF DEBORAH P. FEROLITO, DEPUTY EXECUTIVE DIRECTOR, NEW YORK CITY INDUSTRIAL DEVELOPMENT AGENCY

Ms. **Ferolito**. Thank you, Mr. Chairman, for giving me the opportunity to explain to this committee how New York City administers its revenue bond program.

New York City relies upon its ability to provide incentives to induce industrial expansion and retention where it would otherwise not occur.

Since the New York City Industrial Development Agency's creation in 1974, the issuance of tax-exempt industrial revenue bonds, together with the other incentives offered through the program, has generated over $200 million in capital investment, retained 16,000 jobs, and created an additional 10,000 new jobs in New York City.

Ninety percent of these financings were on behalf of small businesses and all were for industrial purposes.

The agency provides real estate tax abatements and exemptions in conjunction with revenue bond financing. However, real estate tax abatements, alone, cannot mitigate all of the adverse conditions existing in some communities. The availability of low-cost financing, provided through the use of industrial revenue bonds, often makes the difference in the decision to expand or locate into the area.

For instance, New York City has specifically designated eight distinct tracts of land in the outer boroughs of the city as industrial parks.

In one of the largest, College Point Industrial Park, vast sections of undeveloped land have extremely poor subsurface soil conditions. The need for piling in these areas drastically increases the cost of construction.

The use of revenue bonds as an offset to the additional cost of locating into College Point is often the determining factor in a small business' ability to afford a project in the park.

Developing an industrial community, despite its inherent adversities, serves the public purpose of stimulating investment and job creation.

The agency employs stringent eligibility criteria in evaluating a loan application. It must be determined that the financing is the only alternative to induce the project to go forth. Additionally, the project must be able to carry the increased debt generated as a result of the expansion.

If the project cannot satisfy these two crucial elements, it will not be approved. In fact, approximately 60 percent of all telephone inquiries and one out of three meetings conducted with the agency staff are deemed ineligible for IRB financing.

Often revenue bonds provide the margin of difference in the ability of a small business to expand. According to the Commissioner of the Bureau of Labor Statistics, the increase in national unemployment rate was most noticeable in those industries sensitive to continuing high interest rates.

In an environment of persistent high rates and costly real estate, revenue bonds can provide the only access to the much-needed funds for capital investment and are the crucial element in the small business' ability to expand and even stay in business.

To preserve the effectiveness of revenue bonds, they must be properly and responsibly administered. If bonds were issued to every company that applied, without consideration of public purpose, it would severely impair the ability of those companies most in need to obtain financing.

Therefore, with the appropriate test of inducement by the issuing entity, revenue bonds can provide increased access to low-cost private money to small businesses for capital investment without costly appropriation and administration of governmental programs.

Industrial revenue bond financing, when appropriately used, is one of the most cost-effective economic development tools available today.

Thank you.

Senator D'AMATO. Thank you.

Mr. Auffarth, vice president of Chemical Bank.

STATEMENT OF HANK AUFFARTH, ACCOUNT OFFICER, CHEMICAL BANK OF NEW YORK

Mr. AUFFARTH. Thank you.

The Federal Government should allow the IRB bonds to continue, because they provide the most effective incentive for middle market manufacturing companies to expand plant and equipment, thereby retaining and expanding manufacturing-related jobs.

I am Hank Auffarth, and I am an account officer of Chemical Bank in Queens. My job includes the handling of middle market companies and the development of new accounts and new projects.

Queens is one of the five boroughs of New York City. As a part of it, Long Island City is considered the manufacturing hub of New York.

The sales side of the companies I deal with are from $1 million to $100 million with the majority in the $5 million to $15 million range.

The size of the IDA's I have been involved with are from half a million to $5 million with most deals in the $1.5 million range.

The manufacturing companies are primarily small corporations and proprietorships normally started by an entrepreneur or a family-run business.

I believe I have been asked to be here because over the past 3 years I have directly provided the funds for about 12 projects and am familiar with many of the other projects in the Queens area.

In my view, the IDA has provided the middle market companies with a catalyst to invest their private capital in new and expanded facilities, as well as the purchase of new capital equipment.

Through the IDA, a company contemplating expansion has been in a position to show the bank a better feasibility for the project because of lower interest costs and tax abatements. Showing the ability to service the debt, induces the bank to provide the financing and allow us to purchase the IRB's.

Without the benefits provided by the IDA, a project cost would be significantly larger. In some cases, it would make it economically unfeasible.

Without the IDA, many projects I have been involved with would have been canceled, delayed, or certainly scaled down.

In many cases, without the IDA the return on assets would not be sufficient to induce the middle market company to expand its facility.

The people who are employed by the middle market manufacturers are blue and white collar, low- and middle-income workers.

If jobs are going to be provided by other than Government and large corporations, then middle market companies need tax incentives and moderate financing to induce our entrepreneurs to invest in plant and equipment. We must help the middle market manufacturer because they employ the local people who are currently feeling the effects of the cutback in the social programs.

There also appears to be a business expansion multiplier effect due to the efforts of the IDA. A carpet manufacturer, located in Flushing, contemplated expansion from six noncontiguous buildings in a three-block area to one 90,000 cost-efficient manufacturing facility in the College Point Industrial Park.

The only feasible way for that project to take place and for the bank to finance the project was made available through IDA financing.

The expansion to a new facility allowed two smaller manufacturers to expand into their old facility. One was a commercial offset printing company which ran out of space and needed to expand and purchase new equipment. Only with IDA's help was the company able to expand.

Under conventional financing, the bank would not have been in a position to provide the loan because it would not have been cost justified.

The printer's former space is now being rented to an emerging manufacturing company. Therefore, the IDA directly allowed two companies to expand and created a ripple effect in the industrial space, allowing room for growth for many other smaller manufacturers.

The future of middle market manufacturing expansion is most impacted by what happens to the IDA. If we want our middle market corporations to be in a position to expand and create new jobs, we must give them the means to make it economically feasible to expand their plants and equipment.

That is the end of my speech.

I am "Hank from the bank," and my fun in life is doing deals. If you cut out the IDA program, you are going to cut my fun in half.

Thank you very much.

Senator DIXON. Mr. Chairman, may I ask "Hank from the bank" one question for the record?

Senator D'AMATO. Absolutely.

Senator DIXON. Mr. Auffarth, in connection with the financings which have taken place using IRB, in your opinion, would these financings have taken place without the tax-exempt feature of these IRB's?

Mr. **AUFFARTH**. I cannot say in all cases. I would say that at least in half of them certainly they would not have taken place.

The other ones, I would say, they probably would have expanded but on a much more moderate basis.

The one in the College Point Industrial Park was a major one.

Senator **DIXON**. Yes; I thought that was an excellent example.

Mr. **AUFFARTH**. That just would not have happened.

Senator **DIXON**. Thank you.

Mr. Chairman, the next witness here is an old friend of mine. He is an outstanding Illinois State legislator from Decatur who just passed some very significant legislation affecting the farm groups in our State.

I am delighted to introduce to you in this room my good friend, State Representative Tim Donovan from Decatur, Ill.

STATEMENT OF HON. TIM DONOVAN, STATE REPRESENTATIVE, ILLINOIS STATE LEGISLATURE, DECATUR, ILL.

Mr. **DONOVAN**. Thank you, Senator, and Mr. Chairman.

Senator **D'AMATO**. Mr. Donovan, it is nice to have you with us.

Mr. **DONOVAN**. My name is Tim Donovan. I am an active farmer in central Illinois. I am also an elected member of the Illinois House of Representatives in Springfield, as Senator Dixon has indicated.

Decatur, Ill., is the soybean capital of the world. It is also the home base for Archer-Daniels-Midland in its great gasohol effort. We are very proud of Decatur.

What I am here for, as the Senator has indicated, is that this past year I sponsored legislation which passed the general assembly and was signed last month by Governor Thompson to create the Illinois Farm Development Authority.

There is in this new law which was House bill 607, while it was in the process of being passed, an authorization of issuance of up to $50 million in revenue bonds for the purpose of helping farmers in our State.

It is my involvement with this issue this past year that brings me to you today.

The Internal Revenue Service Ruling 81-216 would effectively kill this authority before it is even organized.

It would, in effect, make only small bond issues tax-exempt.

While it is true that our Farm Development Authority adopts the limitations of the Farmers Home Administration, which makes loans of no more than $300,000 impossible, yet it is not likely that bond issues of such sums would be marketable.

The umbrella issue covering a number of loans and individuals would seem to be the only logical or possible answer.

My fellow farmers in my district, particularly young farmers and new farmers trying to get themselves established as independent producers, have been on my neck for the last couple of years since we have had the infamous grain embargo and certainly skyrocketing interest rates.

That is why I and other people in the State Legislature in Illinois got together and estabished this law to help people help themselves who have not really yet established credit ratings or a line of credit. When they did, certainly the embargoes and droughts and high interest rates took them out of their cash flow positions into a negative position.

This would certainly allow them through the FHA to come back into the markets and be independent producers.

Farming is more than a business; it is an industry. It certainly is in central Illinois.

The tools of that industry are certainly combines, tractors, tillage equipment, and things like that. They are not cheap anymore. A tractor today would cost you $40,000 to $50,000 and probably will not last much longer than your family car. Combines today start at around $75,000.

This is not for big farmers. I am talking about family-sized operations.

You begin to see now what demand we need for secondary money coming into the markets.

We tailored the Illinois legislation to the Illinois financial situation. We have more than 1,200 independent banks in the State of Illinois, along with 225 savings and loan associations. This type of agricultural authority financing would provide a vital secondary money market for these institutions.

Through the lower interest money made available by the State authority that had issued revenue bonds, the rural lending institutions would be able to expand their supply of lendable funds for long-term loans to farmer customers.

As one who has a Caterpillar Tractor Co. plant in his home district, I am mindful of the severe economic plight which has hit the big farm equipment industry in our State. Most Deere & Co. and International Harvester Co. farm equipment comes from our Illinois plants.

I followed with great interest the thrust of the new administration here in Washington. I feel it is important that the Farmers Home Administration, for example, be brought back into the business of helping producing farmers.

Whether we are Democrats or Republicans in Illinois, I think you will find that we all want to see our lending institutions sustained and helped by Government—not supplanted by Government. That is why we have had such support for the concept of the agricultural revenue bonds, backed up by the Farmers Home Administration loan guarantees, as well as the limitations involved in them.

I know you are used to dealing with millions and billions here in Washington. We like to brag about Illinois exporting $6.5 billion in agricultural products, making it the biggest exporter of any of the 50 States in our Union.

We also think small about family farms and about the whole business of how one gets that first step on the ladder of credit which enables the farmer to get going as a producer.

I would hope that you find this program worth saving. I really and truly do. Reform it if you will, but please do not kill it.

Senator DIXON. Mr. Chairman, I just want to say to my friend and colleague, Tim Donovan, that I talked to Governor Thompson late last week, as the chairman of our subcommittee knows. He is very supportive of our position.

Mr. DONOVAN. Very supportive.

Senator DIXON. I am happy to report that. He was not able to be here this morning.

Tim, let me ask you this just for the record.

In your opinion, what would the effect of this Internal Revenue Service Ruling 81-216 be with reference to House bill 607 which you passed in the last session of the legislature and Governor Thompson signed and which is now a law in our State?

Mr. DONOVAN. It would kill it.

Senator DIXON. That is my opinion too.

Mr. DONOVAN. Pure and simple.

Senator D'AMATO. House bill 607?

Mr. DONOVAN. House bill 607 was the legislation; yes.

Senator D'AMATO. In terms of dealing with the agricultural community?

Mr. DONOVAN. Yes.

Senator D'AMATO. And making the bonding available?

Mr. DONOVAN. Yes.

Senator D'AMATO. You have testified very eloquently to the fact that urban America and maybe suburban America are not conversant with the fact that the small family farmer has a need for a large capital investment if he is going to be competitive in today's market.

I just visited a farm last Saturday in New York.

By the way, we did not export $6.5 billion last year; but our agricultural base accounted for approximately $6 billion in revenue statewide.

I saw one of the machines used to pick grapes. It cost $90,000.

Of course, without having to go into detail, we know how difficult it is to make those kinds of capital investments for equipment and machinery which are necessary just to be competitive.

The other thing is that the farmer has done so much for America. He has increased his productivity about fivebold in the last 30 years. That is how much more is being produced for each acre.

What would our battle against inflation be without that?

Thank you.

Senator DIXON. I want to thank this panel very much, Mr. Chairman, for their fine contribution to this hearing.

Senator D'AMATO. I would like to say to "Hank from the bank" that we want to keep you operating and working in the fashion you have been in keeping the small business entrepreneur a vital part of our economy.

I think it is particularly gratifying to see someone from the bank who is totally unabashed in making known the fact that he delights in putting these deals, as you call them, together because they have a most beneficial impact for all of us.

Thank you.

[The prepared statements of Mr. Smith, Mr. Schuman, Ms. Ferolito, and Ms. Donovan follow:]

SBI SMITH BROTHERS INSURANCE, INC.

TESTIMONY OF ROBERT J. SMITH
PRESIDENT OF SMITH BROTHERS INSURANCE, INC.

to the

URBAN & RURAL ECONOMIC SUBCOMMITTEE

of the

SENATE SMALL BUSINESS COMMITTEE

SENATOR ALPHONSE D'AMATO of NEW YORK, CHAIRMAN

MONDAY, OCTOBER 5TH, 1981

9:30 A.M.

ROOM 424 - RUSSELL SENATE OFFICE BUILDING
WASHINGTON, D.C.

SBI SMITH BROTHERS INSURANCE, INC

MY NAME IS ROBERT J. SMITH, PRESIDENT OF SMITH BROTHERS INSURANCE, INC., LOCATED AT 5 OAKLAND ROAD IN SOUTH WINDSOR, CONNECTICUT. WE ARE A MULTIPLE LINE INDEPENDENT INSURANCE AGENCY.

IN 1961 I STARTED MY BUSINESS BY TAKING A LOAN FROM AN INSURANCE COMPANY. AT THAT TIME I HAD TWO CHILDREN, WITH NO OTHER SOURCE OF INCOME. APPROXIMATELY TWELVE YEARS AGO, MY BROTHER BRIAN AND I MERGED OUR RESOURCES AND FORMULATED THE PRESENTLY EXISTING ENTITY.

MY BACKGROUND AND EXPERIENCES WITH NUMEROUS ACTIVITIES, ALONG WITH WORKING CLOSELY WITH SMALL BUSINESS ENTREPRENEURS ARE:

- AIDE TO FORMER CONGRESSMAN, WILLIAM R. COTTER
- COUNCILMAN, DEPUTY MAYOR AND MAYOR, TOTALING 6 YEARS IN THE TOWN OF SOUTH WINDSOR.
- SERVING ON ADVISORY BOARDS FOR A BANK, A HOSPITAL AND A CHURCH.
- DELEGATE TO THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS.
- MEMBER OF THE SMALL BUSINESS ADMINISTRATION ADMINISTRATOR'S NATIONAL ADVISORY COUNCIL
- MEMBER OF THE SMALL BUSINESS ADMINISTRATION REGIONAL ADVISORY COUNCIL.

MY INTEREST IN TESTIFYING TODAY IS SOLELY FOR THE BETTERMENT OF THE SMALL BUSINESS ECONOMIC CLIMATE. I HAVE NEVER RECEIVED ANY COMPENSATION FOR PACKAGING LOANS; BUT CERTAINLY, AS A SMALL BUSINESS PERSON DOING BUSINESS ON A REGULAR BASIS WITH OTHER SMALL ENTITIES, THAT HAVE AVAILABLE TO THEM PROPER LONG-TERM FINANCING, MY AGENCY WOULD BENEFIT INDIRECTLY.

THE RECENT REVENUE RULING 81-216 PROHIBITING THE ISSUANCE OF MULTIPLE LOTS OF ONE MILLION DOLLAR TAX EXEMPT INDUSTRIAL DEVELOPMENT BONDS IS DEVASTATING TO SMALL BUSINESS ENTREPRENEURS AT THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS ATTENDED BY OVER 1500 SMALL BUSINESS PERSONS THROUGHOUT THE COUNTRY, THE MESSAGE CLEARLY STATED FREQUENTLY WAS THAT GOVERNMENTAL REGULATORY AGENCIES SHOULD STUDY THE ECONOMIC IMPACT ON SMALL BUSINESS BEFORE ENACTING OR ELIMINATING REGULATIONS. I AM NOT AN EXPERT ON TAX EXEMPT INDUSTRIAL DEVELOPMENT BONDS, BUT I CAN GIVE YOU VERY SPECIFIC EXAMPLES OF THE IMPACT THESE BONDS HAVE HAD, OR WILL HAVE, ON SMALL BUSINESS IN CONNECTICUT.

MURRAY GERBER, PRESIDENT OF PROTOTYPE AND PLASTIC MOLD CO., INC. FROM MIDDLETOWN, CONNECTICUT, CONSTRUCTED AN 18,000 SQUARE FOOT PLANT THAT HE WOULD NOT HAVE BEEN ABLE TO BUILD WITHOUT THE USE OF CONNECTICUT ECONOMIC DEVELOPMENT TAX EXEMPT BONDS. AFTER ONE YEAR, MURRAY HAS HIRED AN ADDITIONAL TWENTY EMPLOYEES AND FINANCED $180,000 IN MACHINERY. PRESENTLY, HE IS PLANNING TO

EXPAND HIS PLANT TO HOUSE ADDITIONAL COMPUTERIZED EQUIPMENT VALUED AT $500,000. THE EXPANSION WILL NOT OCCUR WITHOUT TAX EXEMPT BONDS BECAUSE THE NUMBERS DON'T WORK IF THE FINANCING IS PRIME PLUS 1 1/2%.

HARTFORD FAIENCE COMPANY IN HARTFORD, CONNECTICUT EMPLOYS OVER 125 MINORITIES AND FIRST GENERATION IMMIGRANTS. THEY ARE SEMI-SKILLED EMPLOYEES MANUFACTURING PORCELAIN ELECTRICAL INSULATORS. THE COMPANY NEEDS MORE SPACE FOR UPDATED MACHINERY SO THEY CAN CONTINUE TO BE A VIABLE OPERATION AND MAINTAIN THEIR SALES GROWTH. MR. GERALD McGRATH, GENERAL MANAGER AND TREASURER, INDICATES THAT HIS COMPANY WILL NOT EXPAND IF THE INTEREST RATES REMAIN AT THE PRESENT HIGH LEVEL AND THE TAX EXEMPT BONDS BECOME UNAVAILABLE.

BERNIE AND VIC ZIONTS FROM BERVIC CO. IN BLOOMFIELD, CONNECTICUT WERE CONTEMPLATING MORE EXPANSION TO HOUSE THEIR GROWING INVENTORY. BERNIE AND VIC STARTED THE BUSINESS AFTER SERVING IN WORLD WAR II IN THE NAVY. THEY ARE IN THE RETIREMENT RANGE WITH THE SECOND GENERATION NOW AT THE MIDDLE MANAGEMENT LEVEL. THEIR BUSINESS, AND THE CONTINUED SUCCESS OF IT, WILL BE THEIR RETIREMENT PROGRAM.

DAVID AND DENNIS SILVA, DARI FARMS ICE CREAM CO., INC. TOLLAND, CONNECTICUT ARE TWO UNDER-THIRTY YEAR OLD ENTREPRENEURS THAT WORK SIX DAYS AND NIGHTS PER WEEK BUILDING A FAST-GROWING ICE CREAM AND YOGURT DISTRIBUTORSHIP. THEY SELL THEIR PRODUCTS AND

SHIP THEM IN THEIR OWN VEHICLES AS FAR WEST AS CALIVORNIA AND AS FAR SOUTH AS FLORIDA. THEY HAD TO CURTAIL THEIR PLANT EXPANSION RECENTLY AND INSTEAD BORROWED ONLY $60,000 AT PRIME RATES TO CONSTRUCT AN ASPHALT PARKING AREA. BECAUSE OF HIGH INTEREST RATES, THEIR ACCOUNTS RECEIVABLES ARE GROWING. LARGE-SIZE COMPANIES ARE DELAYING PAYMENTS, CHOOSING EITHER TO SHORT TERM INVEST THE MONEY OR USE IT TO CARRY THEIR OWN RECEIVABLES.

BARBOUR & BARBOUR ASSOCIATES, INC. WAS ESTABLISHED BY BARBARA BARBOUT IN 1977 IN THE BASEMENT OF HER HOME IN ENFIELD, CONNECTICUT. THE COMPANY BEGAN AS A GRAPHICS SHOP AND SUB-CONTRACTED PRINTING TO OTHER PRINT SHOPS. B & B'S REPUTATION FOR HIGH QUALITY WORK WAS QUICKLY ESTABLISHED THROUGHOUT THE BUSINESS COMMUNITY. TODAY, THEY ARE A FULL-SERVICE PRINTING OPERATION WITH OVER EIGHTY-FIVE EMPLOYEES AND ANNUAL SALES EXCEEDING $5,000,000. HOWEVER, SOMETHING HAPPENED ON THE WAY IN THIS SUCCESS STORY. B & B'S BILLING TERMS WERE NET 10 DAYS, WHILE PAYING ITS PRINTING BILLS WAS NET 30 DAYS. THEREFORE, THEY ALWAYS HAD PLENTY OF CASH IN THE BANK. THE MARKET PLACE CHANGED. PAPER, THE LARGEST COST ITEM, WAS IN SHORT SUPPLY. THEREFORE, THEY WERE FORCED TO CARRY SIX MONTHS SUPPLY OF INVENTORY TO BE CERTAIN THEY HAD THE NEEDED AMOUNT. THE PAPER PRICES BECAME INFLATED AND THEY HAD STORAGE PROBLEMS. MOST OF THESE PROBLEMS HAVE BEEN TURNED AROUND DUE TO GOOD MANAGEMENT AND SKILLFUL WORK IN THE MARKETPLACE. HOWEVER, THEY ARE NOW WORKING AT FULL CAPACITY, TWENTY-FOUR HOURS

A DAY. THERE IS PRESENTLY NO PRESS TIME AVAILABLE. UNLESS THEY CAN EXPAND THEIR FACILITIES AND CONTINUE THE CONSISTENT UPWARD PATTERN ENJOYED SINCE ITS INCEPTION, THEY WILL BECOME STAGNANT AND LARGER COMPANIES WILL EVENTUALLY TAKE OVER MANY OF ITS CUSTOMERS.

THE SUCCESS OF THESE COMPANIES IS THE REASON WHY CONNECTICUT ENJOYS AN UNEMPLOYMENT RECORD SIGNIFICANTLY BELOW THE NATIONAL AVERAGE. MANUFACTURING EMPLOYMENT ROSE BY 52,000 FROM 1975 to 1980. THE RIPPLING EFFECTS OF THE TAX EXEMPT INDUSTRIAL REVENUE BONDS IS A MAJOR SIDE BENEFIT TO ALL OF US:

- A LOWER DEBT SERVICE PERMITS MORE FUNDS AVAILABLE TO PURCHASE MACHINERY, CREATING MORE MANUFACTURING JOBS.
- THE AVAILABILITY OF TAX EXEMPT IDB'S WILL NOT ONLY ASSIST A COMPANY FINANCIALLY BUT THE VARIOUS OTHER GOVERNMENTAL GENCIES ARE PLUGGED IN (SUCH AS OSHA and SBA) TO ASSURE SUCCESS OF THE COMPANY AND BE CERTAIN LOANS ARE REPAID.

IT HAS BEEN SAID THAT THE CONNECTICUT DEVELOPMENT AUTHORITY COULD BE A MODEL FOR THE REST OF THE COUNTRY. OVER FIVE HUNDRED COMPANIES HAVE USED THE PROGRAM SUCCESSFULLY. IF THE BROADER QUESTION ON TAX EXEMPT IDB'S IS TO BE ANSWERED, WE NEED TIME TO STUDY THE IMPACT ON SUCH COMPANIES THAT I HAVE MENTIONED HERE TODAY.

I URGE YOUR SUPPORT OF SENATE BILL 1635, A BILL TO DELAY THE APPLICATION OF REVENUE RULING 81-216 UNTIL JANUARY 3, 1983.

FULL TESTIMONY TO BE DELIVERED BEFORE
THE SENATE SUBCOMMITTEE OF THE SMALL
BUSINESS COMMITTEE ON URBAN AND RURAL
ECONOMIC DEVELOPMENT BY KENNETH S.
SCHUMAN, COMMISSIONER, NEW YORK CITY
OFFICE OF ECONOMIC DEVELOPMENT, AT
THE HEARINGS SCHEDULED ON MONDAY,
OCTOBER 5, 1981, at 11:20 A. M.

New York City supports the continuation of Industrial Revenue Bond financing to assist in its local economic development efforts. The availability of this tool is necessary in the attempt to encourage small business expansion and retention. Small business is the major source of employment in the City, as well as the nation, and that sector of the business community most in need of governmental incentive. Industrial revenue bond financing in New York City is primarily geared toward assisting small business expansion and capital investment. The elimination of this important tool will create a severe setback in New York's economic development efforts.

On Friday, the Congressional Joint Economic Committee received testimony from the Commissioner of the Bureau of Labor Statistics, Dr. Janet L. Norwood. She stated that the present national unemployment rate of 7.5% rose again as it had in the past two consecutive months, illustrating that "at best, the economy is very flat." New York City's jobless rate, according to the Bureau of Labor Statistics has also increased, while the neighboring states' unemployment rates have decreased. New York City's unemployment rate stands at 8.4%, which is 9/10 of one percent higher than the national average.

New York City has identified the major problems experienced by industry operating in the City as high taxes, utility costs and escalating real estate costs.[1] A severe industrial out-migration has occured in the past 20 years, primarily due to these factors. Between 1961 and 1975, the City lost over 300,000 manufacturing jobs, approximately 1/3 of which resulted from industrial migration to neighboring states.[2] Since 1975 and the creation of the New York City Industrial Development Agency, this migration trend has been stemmed, although not reversed. In 1980 alone, the City suffered a net decline of 20,000 manufacturing jobs. In fact, in order to meet the national employment population ratio, New York City would need to add 300,000 jobs.

Industry is subject to like environmental conditions and if it becomes prohibitive to operate in a given locality absent an offsetting incentive to remain and expand in the area, an industry migration trend will occur. Given the incentives provided through the revenue bond program in New York City, industry can be encouraged to maintain and expand operations in an otherwise unprofitable environment.

Industrial revenue bond financing has proven to be a mitigating factor in the retention of certain industries in New York City. A good example is the printing industry. In the last decade, 264 printers relocated to areas outside New York City, resulting in a loss of 3,319 jobs.[3] This out-migration occured primarily due to the increased cost of operating in New York City together with the advent of new technology and the recent ease of travel, all of which diminished the necessity for close geographical proximity of printer to client. Therefore, printers were able to take advantage of lower operating costs in neighboring localities. Since 1975, the New York City Industrial Development Agency has induced 14 printing companies to stay and expand their operations in New York City. These financings stimulated over $30 million of capital investment, retained 13,400 printing jobs and created an additional 7,100 new jobs. The use of revenue bond financing to offset some inherent disadvantages of doing business in New York City has made a major contribution to the reversal of the migration trend of printers to other states, as well as stimulated capital investment and job creation in the City.

Revenue bond financing has also helped reverse declining economies of marginally distressed industrial communities. In 1975, industrial space in Long Island City, Queens, averaged $1.50 to $2.00 per square foot and there were many vacant industrial facilities with severe real estate tax arreages. Today, the price per square foot has doubled and most of the industrial facilities are productive, job creating and tax generating buildings. The New York City Industrial Development Agency has assisted the acquisition of 41 industrial facilities in this once marginal area of Queens, stimulated $52 million of investment in the area, retained 4,513 jobs and created 2,528 new jobs in the community. Long Isl[illegible]ty is now a prime industrial area and illustrative of how revenue bond financing contributed to the recovery of a marginally distressed area of the City.

Further, the development of marginally distressed areas of the City has significant impact upon the neighboring residential communities. In an urban environment such as New York City, where sophisticated mass transportation networks allow greater mobility of the labor pool, jobs created in industrial communities help the economic growth of neighboring residential communities by increasing the per capita income, and spending power with the concommittant ripple effect within the community. In fact, an analysis of the ratio of dollars forgone in the form of real estate tax incentives provided in conjunction with revenue bond financings to the dollars generated for the City as a direct result of the IRB stimulated investment, shows a net increase of revenue to the City.

In conclusion, the use of Industrial Revenue Bonds to stimulate investment serves to strengthen New York City's economy by reducing enemployment, increasing the economic vitality of marginal and distressed communities and increasing the corporate, personal and real estate tax base of the City. Revenue Bonds are a vital tool in the continued, successful economic development of New York City, and their use are still a necessary ingredient to the future economic health and vitality of the City.

Thank You.

NEW YORK CITY INDUSTRIAL DEVELOPMENT AGENCY
225 BROADWAY, ROOM 1200, NEW YORK, N.Y. 10007 (212) 267-9600

WILLIAM S. BRENNEN
CHAIRMAN

PHILIP E. AARONS
EXECUTIVE DIRECTOR

FULL TRANSCRIPT OF TESTIMONY TO BE DELIVERED BEFORE THE SENATE SUBCOMMITTEE OF THE SMALL BUSINESS COMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT BY DEBORAH P. FEROLITO, DEPUTY EXECUTIVE DIRECTOR OF THE NEW YORK CITY INDUSTRIAL DEVELOPMENT AGENCY, AT THE HEARINGS SCHEDULED ON MONDAY, OCTOBER 5, 1981, AT 11:20 A.M.

New York City relies upon its ability to provide incentives to induce industrial expansion and retention where it would otherwise not occur. Without the means to offset some of the inherent disadvantages to small businesses in New York City, such as high energy costs, unionized labor requirements, high corporate, personal and real estate taxes, as well as escalating realty values, a decline in the economy would be inevitable.

Since the New York City Industrial Development Agency's creation in 1974, the issuance of tax exempt industrial revenue bonds together with the other incentives offered through the program has generated $205,190,410 in capital investement, retained 16,177 jobs and created an additional 9,232 new jobs in New York City.

The Agency provides real estate tax abatements and exemptions in conjunction with revenue bond financing.

TAX ABATEMENTS AND INCENTIVES

It is the IDA's policy to offer eligible industrial companies the following real property tax abatements and exemptions.

1. Land tax abatement in an amount equal to $250 x the number of employees the applicant has at the time of approval. This amount is further limited to the percentage of occupancy the eligible company has in the facility, and runs for the term of the financing.
2. Ten-year stabilization of the real estate taxes on the building at current tax rate and assessment.
3. As an alternative to the ten-year stabilization, the applicant can choose to have the payment in lieu of taxes in another manner:
    a) for a project involving the acquisition of an existing facility, the payment can be calculated as 95% tax abatement in the first year after renovations are complete on that portion of the taxes imposed over and above the base assessement as a result of the renovations. This abatement decreases 5% per year.
    b) for new construction, a 50% tax abatement applies to the increase in the assessed value and declines 5% per year for 10 years. This alternative does not stabilize the base assessed value or tax rate on the property.

For commercial-type projects, the real estate tax relief is determined on a per project basis.

Additional tax benefits offered under the IDA program are:

1. Exemption from the New York State Mortgage Recording Tax (1-1/2%)
2. Exemption from the New York Real Property Transfer Tax (1%)
3. Exemption from the New York City and State Sales Tax (8%) on all fixtures and materials which are used in construction.

However, real estate tax abatements alone cannot mitigate all of the adverse conditions existing in some communities and the availability of low cost financing provided through the use of Industrial Revenue Bonds, often makes the difference in the decision to expand or locate into the area..

For instance, New York City has specifically designated eight distinct tracts of land in the outer boroughs of the City as Industrial Parks. In one of the largest, College Point Industrial Park, (presently one-third developed) vast segments of undeveloped land have extremely poor subsurface soil conditions. The need for piling in these areas drastically increases the cost of construction. The use of Industrial Revenue Bonds as an offset to the additional cost of locating into College Point often is the determining factor in a small business' ability to afford a project in the park.

Developing an industrial community despite its inherent adversities serves the public purpose of stimulating investment and job creation. New York City feels it is necessary to have governmental incentives such as Industrial Revenue Bond financing available to assist these efforts.

The Agency employs stringent criteria to determine whether or not an applicant is eligible for revenue bond financing.

In industrial projects, it must be determined that the financing is the only alternative to induce the potential project to go forth. In addition, the project must be able to carry the increased debt generated as a result of the expansion, based upon the Agency's independent credit analysis. If the project cannot satisfy these two crucial elements, the application will not be approved for financing. In fact, approximately 60% of all telephone inquires and one out of three meetings with Agency staff members are deemed ineligible for IRB financing.

Inducement is evaluated by taking a number of factors into consideration. In a retention situation, in addition to the applicant's written, signed representations to the Agency, an independent determination is made as to the geographical mobility of the business. This is done by examing the location of customers and suppliers, methods of distribution, service and sales, availability of labor, and transportation. Industry migration trends are often illustrative of a particular company's ability to relocate as is the personal circumstances of the owners, where they and their families reside and their ability to commute to alternative sites outside of New York City.

If it is determined that the business reasons exist to support the company's contention that it can in fact move out of the City, then an effort is made to determine whether or not it really will move absent Industrial Revenue Bond financing. In this regard, it is important to consider the disadvantages of relocation against the stated advantages of relocation. A determination is made as to which are the realistic overriding factors in the business relocation decision. For example, the benefits of lower overhead and operating expenses in the alternative location could be weighed against the disadvantages of disrupting the existing work force and the necessity to hire and train new people in the new location.

In an instance where a company must move out of its existing facility to another location, either in New York City or outside the State, the cost of moving is not an issue. However, if a company wants to buy the building it is presently leasing, the impact and feasability of a move must be closely examined. Therefore, depending on the particular circumstances of the company and its stated alternatives, a best efforts determination can be made as to the actual need of the Industrial Revenue Bond financing as an incentive to induce the expansion and retention of the business in New York City.

The determination of inducement is also closely allied with the debt service analysis performed by the Agency. Often Industrial Revenue Bonds provide the margin of difference in the small business' ability to expand. In some instances, when a company is in a desperate situation, (for example at the expiration of its lease, facing a prohibitive increase in rental) it can mean the difference between remaining in existance or liquidation. According to Dr. Janet L. Norwood, the Commissioner of the Bureau of Labor Statistics, the continued increase in the national unemployment rate (which she recently testified to before the Congressional Joint Economic Committee) was most noticable in those industries sensitive to high interest rates. In an enviornment of persistent high interest rates and costly real estate, Revenue Bonds may provide the only access to much needed funds for capital investment and can be crucial element in the small businesses ability to expand or even stay in business.

All of these elements are strongly considered in making a determination of inducement. If the agency feels the expansion or retention would occur without the use of the bonds, the project will not be approved.

In the case of commercial facilities, the Agency employs a set of criteria which attempts to insure the public purpose is being met and that the project will result in a net increase in jobs in the community. Four principals are used in the review of all commercial projects:

1. That the Agency would not have financed the particular project except to induce the location or expansion of such project in the area to be served by the project as there is a demonstrable need for such project and the service it offers.
2. But for the availability of industrial revenue bond financing and benefits for such a project in such an area, the project would not be economically feasible.
3. There would be no substantial disruption of existing employment or facilities of a similar nature in such area.
4. The project will provide substantial employment and substantial capital investment.

To date, the Agency has not financed one commercial-type facility; however, one has been approved for financing. This project is a wholesale cash and carry food distribution company which will have two facilities in two separate economically depressed areas of the City. This project met all of the above criteria in that:

(1) The two proposed locations were situated in two economically distressed areas of the City (one in Brooklyn and one in Queens). The Agency surveyed the small grocery stores in these areas and found that they complained of many economic adversities in operating

INTENTIONAL
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their businesses. One of the major problems was the inability to purchase small quantities of goods from the major wholesale food distributors. The distributors refused to sell or deliver quantities under certain minimum requirements and the small grocers, whose sales did not reflect the need for these minimum quantities, were forced to over-purchase and were often subject to high spoilage losses. In nonperishable goods, the grocers were forced to obtain additional storage space. These circumstances substantially increased their cost of doing business and many small grocers were forced out of business due to these severe conditions.

The cash and carry wholesale food distribution project approved by the IDA will provide the much needed availability of small lots of merchandise to the grocers in these two economically distressed areas of the City. In addition, the grocers will not have to pay additional delivery costs, as they can pick up their supplies from the distribution center. In turn, they can provide their customers with fresher produce and goods at lower prices.

2) As the project called for the new construction of a 100,000 square foot warehouse in one community and the major rehabilitation of another in the second community, cost estimates proved the project to be economically untenable without Industrial Revenue Bond

financing. The investor, a foreign-based corporation, felt that absent the tax-exempt financing and real estate tax benefits offered through the New York City Industrial Development Agency, the return on their investment could not occur for a significant number of years. The interest differential provided by using tax-exempt bonds influenced the decision of the foreign company and induced it to invest in America.

3) It was determined that an unfair competitive disadvantage would not be created for the other food wholesalers in the community since they felt that doing business with the small grocer was not cost effective for them. Further, by lowering their prices, these small grocers are still not going to be extremely price competitive with the supermarkets in the area. They often stay open longer and odder hours than the supermarkets and their relative overhead costs are higher than the larger markets. They serve a different need in the community and do much of their business with a convenience-basis market as opposed to on a price-competitive basis.

4) The project stimulated $9 million of capital investment by a foreign-based company into New York City and created 250 jobs.

To preserve the effectiveness of revenue bonds, the program must be properly and responsibly administered in accordance with the public purpose it serves. If bonds were issued to every company that applied without a determination of eligibility, it would severly impair those truly needy small businesses' ability to obtain financing.

Revenue Bond financing stimulates expansion and investment by providing those marginal companies increased access to low cost capital (generally 75% of conventional rates). To deplete this source of capital by an improperly administered revenue bond program is adverse to the public purpose for which they were created. This is precisely why a strong inducement criterium and appropriate application thereof is an integral factor in the proper administration of a revenue bond program. Providing increased access to low cost private money for small businesses capital investment without costly appropriation and administration of governmental programs makes Industrial Revenue Bond financing one of the most cost effective economic development tools available today.

Thank you.

NEW YORK CITY INDUSTRIAL DEVELOPMENT AGENCY BOARD OF DIRECTORS

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Presentation of State Rep. Tim Donovan, Decatur, Illinois, October 5, 1981 to the Urban and Rural Economic Development Subcommittee of the U.S. Senate Committee on Small Business:

My name is Tim Donovan. I am an active farmer in Central Illinois. I am also an elected member of the Illinois House of Representatives and have been for three years. I come from Decatur, Illinois, the soybean capitol of the world, and also the home base of the Archer-Daniels-Midland Corp. big gasohol effort.

This past year, I was also the sponsor of legislation which passed the Illinois General Assembly and was signed last month into law that creates the Illinois Farm Development Authority. There is in this new law -- which was House Bill 607 while it was in process of being passed -- the authorization for issuance of up to $50 million in revenue bonds for the purposes of helping farmers in our state.

It is my involvement with this issue this past year that brings me to you today.

Internal Revenue Service Ruling 81-216 would effectively kill this authority before it is even organized.

It would, in effect, make only small bond issues tax exempt. While it is true that our Farm Development Authority adopts the limitations of the Farmers Home Administration which would make loans of more than $300,000 impossible, yet it is not likely bond issues on such sums would be marketable. An umbrella issue covering a number of loans and individuals would seem to be the only logical or possible answer.

(more)

My fellow farmers in my district, and particularly young farmers and new farmers trying to get themselves established as independent producers, have been on my neck ever since the infamous grain embargo sent grain prices tumbling while interest rates skyrocketed.

That is why I took the lead with other rural area legislators to get this aggie bond concept before the legislature. We felt it offered a way of helping our young farmers who have not yet established credit ratings for those big-ticket amortized loans they need for equipment purchases.

Gentlemen, farming is more than a business. It is an industry. And the tools of that industry are tractors and combines and other tillage equipment that does not come cheap. A $40,000 or $50,000 tractor can last just about as long as your family automobile. You can't buy a new combine harvestor these days for under $75,000. And we are not talking about big farmers now. We are talking about family farm sized operations. Perhaps you can see why skyrocketing interest rates kill the farmer.

We tailored our Illinois legislation to the Illinois financial situation -- we have more than 1,200 independent banks in Illinois plus more than 225 savings and loan associations. This type of agricultural authority financing would provide a vital secondary money market for these institutions.

Through the lower-interest money made available by a state authority that had issued revenue bonds, the rural lending institutions would be able to expand their supply of lendable funds for long-term loans to farmer customers.

As one who has a Caterpillar Tractor Co. plant in my home district, I am mindful of the severe economic plight which has hit the big farm equipment industry of our state. Most Deere & Co. and International Harvester Co. farm equipment comes from Illinois plants.

I have followed with great interest the thrust of our new administration here in Washington. I feel it is important that Farmers Home Administration, for example, be brought back into the business of helping the producing farmer. Whether we are Democrats or Republicans in Illinois, I think you will find that we also want to see our own lending institutions sustained and helped by government, not supplanted by government. That is why we had such support for the concept of the agricultural revenue bonds, backed up by Farmers Home Administration loan guarantees as well as the limitations involved with them.

I know you are used to dealing in millions and billions here in Washington. We like to brag about Illinois exporting $6.5 billion in agricultural products too, making it consistently the biggest exporter of any of the 50 states.

But there are times to think small, too, about the family farms, and about this whole business of how one gets that first step on the ladder of credit that enables the farmer to get going as a producer.

I hope you will find this program worth saving. Reform it if you will, but please don't kill it.

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Senator D'AMATO. It is my privilege and pleasure to call upon our distinguished colleague, the senior Senator from Vermont, for the purposes of an introduction.

Senator Stafford?

STATEMENT OF HON. ROBERT T. STAFFORD, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator STAFFORD. Thank you very much, Mr. Chairman.

It is a real pleasure to be here and a particular honor for me to have this opportunity to introduce to the subcommittee a long-time personal friend of mine and the most distinguished Governor of our State.

Governor Snelling has been a very successful businessman, and he has turned to politics even more successfully, I think. I think he has been one of the most outstanding Governors we have had. I think his business background has been especially helpful to him in achieving the excellent record he has as our chief executive.

Beyond that, he has further distinguished himself and honored our State by being elected the chairman of the National Governors Conference.

I think Governor Snelling speaks not only for himself—I am sure for myself and Vermont—but probably for the National Governors Conference as well.

I am very pleased to present my friend and my Governor, the Honorable Richard Snelling.

Senator D'AMATO. Thank you very much, Senator.

Governor Snelling?

STATEMENT OF HON. RICHARD A. SNELLING, GOVERNOR OF VERMONT, AND CHAIRMAN, NATIONAL GOVERNORS ASSOCIATION

Mr. SNELLING. Thank you.

The Governors are very pleased that your committee has taken the very prompt action which you did to correct the adverse effects of the August 24 ruling by the Internal Revenue Service 81-216, which would have prevented States from packaging small-issue revenue bonds that benefit small businessmen and farmers.

We just wanted to reinforce our support for what you are doing and to make the Governors Association and its members available to you in any way that will assist you in making the message very clear as to the reasons why we think that ruling is wrong and would be injurious to many national interests.

Industrial revenue bonds are an essential tool for the credit needs of small business in the United States and small manufacturing firms, as well as agricultural firms, and many others.

It makes experienced and reputable State technical assistance available and results in lower costs.

The Governors have unanimously expressed their disapproval of Revenue Ruling 81-216 through the National Governors Association, as well as through each of the regional organizations—each and every one of the regional organizations of Governors.

On September 24, we expressed our concerns directly to the President and to Secretary Regan, at which time the announcement was made that the ruling would be withdrawn.

This past Thursday, the IRS announced that the proposed regulations would be issued on October 5, with an effective date of August 24—in effect, the same date as Revenue Ruling 81-2 6.

This is not, therefore, really a withdrawal but a holding action which continues to have very adverse effects on the viability of these programs.

Your leadership in this hearing will highlight the reasons why the proposed regulation should also be withdrawn or substantially amended.

Gov. Kit Bond of Missouri and Governor Winter of Mississippi, chairman and vice-chairman, respectively, of the National Governors Association Committee on Community Economic Development, could not be here today. They did ask me to submit testimony on their behalf and on behalf of the Governors which I have and would like to present to you.

Senator D'AMATO. It will be included in the record at this point.

[Material follows:]

National Governors' Association

Richard A. Snelling
Governor of Vermont
Chairman

Stephen B. Farber
Executive Director

TESTIMONY

THE HONORABLE CHRISTOPHER S. BOND
GOVERNOR OF MISSOURI

TO

THE SELECT COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON URBAN AND RURAL ECONOMIC DEVELOPMENT

U.S. SENATE

REGARDING

SMALL ISSUE INDUSTRIAL REVENUE BONDS
AND SMALL BUSINESS

OCTOBER 5, 1981

HALL OF THE STATES • 444 North Capitol Street • Washington, D.C. 20001 • (202) 624-5300

I am pleased to appear today on behalf of the National Governors' Association, as the current Chairman of NGA's Committee on Community and Economic Development, to discuss the use of industrial development bonds (IDBs) by state and local governments. As you know, 47 states issue industrial revenue bonds (IRBs) and the principal beneficiaries are small businesses. In fact, the primary utility of IDBs or IRBs is its effectiveness in increasing investment in the smaller firms that provide such a large percentage of this nation's employment and entrepreneurial initiative.

As you may know, Mississippi was the first state to enact legislation, in 1936, authorizing local governments to issue tax-exempt bonds for industrial development projects. The original purpose of those bonds was to promote industrial development and to strengthen the manufacturing employment base of a very depressed, traditional, rural economy. For many years, the use of such bonds usually was aimed at developing and diversifying the economies of relatively poor, rural areas. During the 1960s, they came to be used more frequently to help create jobs or preserve the employment base in major urban centers. As a result of their increased popularity for urban development, IDBs achieved a record dollar volume in 1968. In that year, the Congress acted to curtail their use, and the Revenue Expenditure and Control Act of 1968 has since provided the basic statutory framework for issuance of tax-exempt IRBs. The states adjusted to the restrictions and to their subsequent liberalizations, such as that relating to federal Urban Development Action Grants.

Since 1968, IRBs have been used primarily as a tool to increase capital availability for creditworthy but underfinanced small firms and as a device for attracting business investment or location in otherwise less attractive places. The Fortune 500 and wealthy suburbs have not been the principal beneficiaries of IDBs.

As the dollar volume of IDBs began to increase again, during the late 1970s, due to changes in the federal statute and market factors, the IRB critics came out of the woodwork. During the previous Administration, the Treasury Department delivered testimony critical of IRBs and the Congressional Budget Office raised the spectre of federal revenue loss due to tax exemption.

Now, despite the fact that since 1954 it has formally supported the tax-exempt status of IRBs, the Internal Revenue Service has issued a policy--Revenue Ruling 81-216--that strikes at the innovative use of IRBs to assist credit-short small businesses and struggling small farmers.

Programs in thirty states and Puerto Rico are adversely affected by Ruling 81-216. Twenty-two states stand to lose valuable programs of assistance to small businesses and seventeen will lose their agricultural development programs as a result of this IRS policy.

You should be aware that the effects of Ruling 81-216 are virtually nationwide. This is evidence by the fact that all four regional Governors' associations have passed resolutions opposing the ruling. Copies of those resolutions and other communications from individual Governors are attached as submissions for the record.

This IRS initiative is ironic under an Administration which espouses a return to federalism and has supported liberalization of lease financing, from which IRBs are a financial offshoot. The ruling itself may represent a usurpation of congressional authority by way of bureaucratic rulemaking which exceeds not only the letter, but also the intent, of the law. The procedure employed was certainly deserving of criticism, in that those affected were not forewarned, let alone consulted. In addition, and this is of particular importance to the states, the ruling judges state guarantees of bonds to be equivalent to federal guarantees and denies tax-exemption for those small-issue IRBs that assume the characteristic of a general obligation bond by virtue of a state's unconditional guarantee of principal and interest. This appears to fly in the face of the tenth amendment and the constitutional doctrine of reciprocal immunity.

Congress, rather than the federal courts or the IRS, has acted in the past to limit or expand the tax-exemption of IRBs. In 1914, the Supreme Court decided, in Union Lime Co. v. Chicago-Northwestern Railway Co., that it would not review decisions by state courts concerning what the state government considered to be a promotion of public purpose as defined in its state legislation. The Congress has tended to adhere to a similar principle with regard to decisions by state legislatures. Both have been applied, with few exceptions, to limit federal interference with state authority over the issuance of tax-exempt bonds. However, last year Congress passed the Mortgage Subsidy Bond Tax Act, virtually shutting down state housing finance agency assistance for low- and moderate-income home buyers. Unfortunately, that Act appears to have sent a signal that tax-exempt revenue bonds are fair game. Now the critics of tax-exempt revenue bonds feel that the way is open for them to work their will. Apparently they are in the ascendency at the Treasury Department. I urge you to retake the policy initiative so that the IRB critics do not make the rules of the game for the 1980s. Passage of S. 1635 would be a step in the right direction.

IRBs are an important state and local government financing tool for capital formation and economic development. When virtually all federal economic development programs are slated for termination and many have been eliminated already, IRBs become about the only tool available for financing business development in economically underdeveloped or depressed communities. IRBs are likely to be one of the very few methods by which we can direct scarce credit to small firms suffering from tight money and distressed areas experiencing severe capital shortages.

Both Congress and the Administration have called on the states to take on added responsibilities for community and economic development functions. We are willing, but we need the tools to do the job and the flexibility to use them appropriately.

Economic development needs vary widely among regions, states and localities. If you have seen one distressed community, you have not seen them all. The diversity of development problems underscores the need for IRBs, since absent Revenue Ruling 82-216, they have much of the flexibility necessary for tailoring financial assistance programs to meet state and local realities and priorities.

It is perhaps unfortunate, but nevertheless true, that the tax package enacted this summer is not by any means an adequate substitute for IRB asssistance to small business. In the current monetary policy context, it assists those larger firms that can retain sufficient earnings for self-financing or can publicly issue stock far more than it helps smaller firms that tend to be highly leveraged.

Small businesses, which generally are not in a position to pass on to consumers their increased borrowing costs due to high interest rates, need IRB financing if they are to maintain profitability and avoid bankruptcy. For small start-ups, tax breaks are not of immediate substantial benefit. They do not generate a spontaneous inflow of needed capital to support entrepreneurship. Neither do they make a major difference for most young small firms, since profits tend to be minimum for the first five years and retained earnings tend to be rare. Such is not to say that most, if not all, of the tax reforms aimed at helping small business were not steps in the right direction. It is only to say that other assistance is also needed.

To fill the gap with IRBs, we need access to economies of scale in marketing through pooling of small issues; we need to be able to guarantee issues so that unrated firms can be assisted; we need to be able to deal positively with purchasers' needs for risk diversification in their portfolios. Revenue Ruling 81-216 precludes us from doing so and closes the door on many small businesses.

I appreciate the opportunity to testify on this important issue. I have provided for the record a copy of the NGA policy position in regard to federal legislation governing state and local industrial development bonds. I believe that you will find that it reflects the willingness of the states to accept responsibility for appropriate use of IRBs. We will submit information on the effects of Revenue Ruling 81-216 on specific state programs within the next few days, since time for attorneys' opinions in the various states has been required as part of the impact evaluation.

ATTACHMENTS FOR THE RECORD

(1) Letter from the Coalition of Northeastern Governors to the President, dated September 9, 1981.

(2) Resolution adopted by the Coalition of Northeastern Governors.

(3) Press Release issued by the Coalition of Northeastern Governors on September 14, 1981.

(4) Resolution adopted by the Western Governors' Conference.

(5) Letter from the Midwestern Governors' Conference to the President, dated September 1, 1981.

(6) Resolution adopted by the Southern Governors' Conference

(7) Letter from Governor John N. Dalton of Virginia to the President, dated September 9, 1981.

(8) Letter from Governor Harry Hughes of Maryland to Senators Charles McC. Mathias, Jr., and Paul S. Sarbanes, dated September 18, 1981.

(9) Letter from Governor Christopher S. Bond of Missouri to the President, dated August 27, 1981.

(10) Letter from Robert E. Patterson, Executive Director of the Massachusetts Industrial Finance Agency, to Steven Farber, dated September 21, 1981.

(11) Letter from Governor Edward J. King of Massachusetts to the President, dated September 16, 1981.

(12) Memorandum from Roger L. Peterman, Executive Director of the Kentucky Development Finance Authority, to Jim Martin and Bill Bivens, dated September 30, 1981.

CONEG
COALITION OF NORTHEASTERN GOVERNORS
400 NORTH CAPITOL STREET, N.W.
SUITE 382
WASHINGTON, D.C. 20001
(202) 624-5440

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

September 9, 1981

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

On behalf of the Coalition of Northeastern Governors, we wish to register serious concern regarding the effects of Internal Revenue Service Revenue Ruling 81-216 on state industrial development bond (IDB) programs. This ruling, which was issued without prior consultation, eliminates the current tax exemption for multiple lots of small issue revenue bonds of less than $1,000,000 used to provide loans for small and medium size businesses. We believe this revenue ruling is ill-conceived and represents a dramatic step in the wrong direction for IDBs.

The Northeastern states have pioneered the use of so called "umbrella" or pooled bond issues as a way of targeting tax-exempt financing to smaller firms that face particular difficulties obtaining needed capital in the private market. We view the targeted use of this financing technique as a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast. The effect of this IRS ruling is to severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates.

Congress is currently considering legislative changes to establish more stringent guidelines for state and local IDB programs. In addition, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legislation to ensure the responsible and targeted use of this economic development tool. A copy of this resolution is enclosed for your review. We believe it is a serious mistake for IRS to preempt the legislative process by suddenly reversing longstanding precedents and rulings in this area, and we strongly urge that this ruling be withdrawn.

Thank you for your consideration of this matter.

Sincerely,

J Joseph Garrahy

Governor Dick Thornburgh
Chairman
Coalition of Northeastern Governors

Governor J. Joseph Garrahy
Vice Chairman
Coalition of Northeastern Governors

DT/lw

cc: Secretary Donald T. Regan
U.S. Department of Treasury
John E. Chapoton, Assistant Secretary
U.S. Department of Treasury
Dan Rostenkowski, Chairman
U.S. House of Representatives, Ways and Means Committee
Barber Conable, Ranking Minority Member
U.S. House of Representatives, Ways and Means Committee
Robert Dole, Chairman
U.S. Senate Finance Committee
Russell Long, Ranking Minority Member
U.S. Senate Finance Committee
Northeast Congressional Delegation

CONEG
COALITION OF NORTHEASTERN GOVERNORS
400 NORTH CAPITOL STREET, N.W.
SUITE 382
WASHINGTON, D.C. 20001
(202) 624-5440

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

INDUSTRIAL DEVELOPMENT BONDS

WHEREAS, the Coalition of Northeastern Governors regards industrial development bonds as an important economic and community development tool to stimulate capital investment and employment. At a time when federal development assistance is being sharply reduced or eliminated, this financing mechanism must remain available to State and local governments as a development incentive for private investment and;

WHEREAS, we also recognize that legitimate concerns have been raised regarding abuse of small issue industrial development bonds, particularly those issued for commercial purposes.

THEREFORE, BE IT RESOLVED that the CONEG Governors recommend the following changes in federal legislation in response to that criticism:

- o Target commercial IDBs to distressed areas by providing broad federal guidelines within which States have the flexibility to determine the targeted areas based on State and local economic objectives.
- o Exempt from these restrictions special economic activities which are of particular importance to a specific State's economy and which encompass less than 5 percent of the States's economic base.
- o Exempt all production activities from research processing to warehouse-distribution from targeting limitations.
- o Establish federal monitoring and annual reporting requirements by States for all small issue IDBs issued in each State.

COALITION OF NORTHEASTERN GOVERNORS

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

FOR IMMEDIATE RELEASE
Monday, September 14, 1981

CONEG POLICY RESEARCH CENTER
CONTACT: Connie Saulter
(202) 624-5440

GOVERNORS SAY NO TO IRS RULING ON INDUSTRIAL REVENUE BONDS

WASHINGTON, D.C., September 11 -- Pennsylvania Governor Dick Thornburgh, Chairman of the eight-state Coalition of Northeastern Governors (CONEG) and Rhode Island Governor, J. Joseph Garrahy, Vice Chairman of CONEG, have called for White House withdrawal of a recent Internal Revenue Service ruling that would eliminate the current tax exemption for state industrial development bond pools used to provide loans to small and medium size businesses. The IRS ruling, issued on August 24, would eliminate the ability of states to package a series of small business loans into a single tax-exempt "umbrella" or pooled bond issue.

In a September 9 letter to President Regan, Governors Thornburgh and Garrahy said that the effect of the new IRS ruling will "severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates."

Governor Garrahy noted that the Northeastern states "have pioneered the use of pooled bond issues as a way of targeting tax-exempt financing to small businesses that are shut out of the private capital market." Garrahy cited recent studies which show that small businesses create more than 80 percent of all new jobs in the economy each year, a fact which has led many states to focus on the small business sector in their economic development efforts.

Governor Thornburgh called state industrial development bond (IDB) programs "a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast." "We believe this ruling is ill-conceived and represents a dramatic step in the wrong direction", Thornburgh said.

Several Northeastern states have used "umbrella" or "pooled" IDB's to finance loans to small and medium size businesses. Rhode Island this year has also initiated a similar program that has already assisted a number of small Rhode Island manufacturers.

Connecticut has issued umbrella bonds totalling $195 million over the last ten years. The Connecticut program has provided assistance to more than 500 small firms, and is estimated to support the creation of more than 9,000 new jobs annually in that state.

New York's umbrella bond program has provided loans to more than 1,200 companies, with total employment of over 90,000 workers.

(over)

The Pennsylvania Industrial Development Authority (PIDA) has issued IDB's totalling more than $92 million since 1975, the proceeds of which have financed more than 400 loans to firms employing roughly 33,000 workers. Several other Northeastern states have developed plans for issuing pooled IDB's, but have been stopped by the new IRS ruling.

The Governors expressed concern to the President that this ruling hinders possible action by Congress to enact reform legislation governing the issuance of small issue industrial development bonds. In light of this legislation, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legislation to "ensure the responsible and targeted use of this economic development tool."

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WESTERN GOVERNORS' CONFERENCE
THE COUNCIL OF STATE GOVERNMENTS
185 POST STREET, 5th FLOOR SAN FRANCISCO, CALIFORNIA 94108 (415) 986-3780

Proposed Resolution E:

URGING THE WITHDRAWAL OF IRS REVENUE RULING 81-216

(Introduced by Governor Victor Atiyeh, Oregon)

WHEREAS, the Internal Revenue Service on August 24, 1981, issued Revenue Ruling 81-216 which holds that multiple lots of industrial development bonds of $1 million each will not qualify for the tax exemption under the Internal Revenue Code Section 103(b)(6)(A) if:

(1) the obligations will be sold at substantially the same time,

(2) the obligations will be sold under a common plan of marketing,

(3) the obligations will be sold at substantially the same rate of interest, and

(4) a common or pooled security will be either used or available to pay debt service on the obligations; and

WHEREAS, the lack of capital available to small farms, ranches and small businesses and the present high rates of interest have placed many farms, ranches and businesses in severe economic difficulty resulting in extraordinarily high rates of bankruptcy; and

WHEREAS, many states in the Western Governors Conference have adopted or are considering adopting programs to assist small farmers, ranchers and small businessmen by making available to them the proceeds of $1 million industrial development bonds or agricultural development bonds which have been issued in multiple lots by a state authority; and

WHEREAS, many states have developed these statewide tax-exempt bond programs to help small farms, ranches and small businesses in reliance upon earlier Treasury Department rulings which are reversed by Ruling 81-216;

NOW, THEREFORE, BE IT RESOLVED by the Western Governors' Conference that, as governors of states which have made concerted efforts to help small businesses and small farms and ranches, we urge the President of the United States to withdraw Revenue Ruling 81-216 immediately to avoid any further damage to those state governments which have relied in good faith upon the earlier revenue rulings and to allow the states to utilize these vital programs which often provide the only affordable or available source of credit to struggling farmers, ranchers and businessmen.

[illegible]
GOVERNORS'
CONFERENCE

JAMES R. THOMPSON
Illinois
Chairman

JOHN CARLIN
Kansas
Vice Chairman

CHRISTOPHER S. BOND
Missouri
Past Chairman, [illegible]

JOHN Y. BROWN, JR.
Kentucky

LEE S. DREYFUS
Wisconsin

WILLIAM J. JANKLOW
South Dakota

WILLIAM G. MILLIKEN
Michigan
Past Chairman, [illegible]

ALLEN I. OLSON
North Dakota

ROBERT D. ORR
Indiana

ALBERT H. QUIE
Minnesota

ROBERT D. RAY
Iowa
Past Chairman, [illegible]

JAMES A. RHODES
Ohio
Past Chairman, [illegible]

CHARLES THONE
Nebraska

[illegible]

September 1, 1981

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

The Midwestern Governors have asked me to convey to you our deep concerns about the implications of Internal Revenue Service Revenue Ruling 81-216. This ruling prohibits issuanc of multiple lots of $1,000,000 revenue bonds and eliminates tax exempt financing to assist small farmers. The ruling will have the effect of depriving small farmers and small businesses of much needed sources of capital for farmland, equipment and plant facilities.

As Governors of states which have made a concerted effor to help small businesses and small farms, we believe that thi ruling should be withdrawn. State and local governments have been relying in good faith upon earlier rulings which this announcement reverses, as have many small farmers and small businessmen who are dependent upon the sources of credit which this ruling would eliminate. Hundreds of millions of dollars are involved nationwide in the various loan programs which will be jeopardized by this ruling.

Specifically, the Revenue Ruling would eliminate two fo: of financing which state governments have developed and tailo: to assist small farmers and small businessmen particularly during the past two to three years when credit has been unaffordable or unavailable.

In the first instance, it would eliminate the use of agricultural development bonds, a form of tax-exempt financin used by the states to assist small farmers in the acquisition of farm equipment or farmland. With the sharply diminished role of the FmHA in providing direct or guaranteed loan assistance to American farmers, agricultural development bond: have become an important, and in some areas an exclusive, source of credit to allow small farmers to continue their operations.

Thousands of small businesses also will be deprived of credit because the IRS ruling bars the use of a mechanism developed by the states in which state development agencies put together a package of tax-exempt financing and then make individual loans available to new or expanding small companies. This assistance is aimed at small concerns whose credit would be insufficient to give an individual bond issue a rating which would make it attractive to potential investors. However, when the bond for one small company is grouped together with bonds for a number of other companies, insured credit often is available for the entire transaction, making low-cost financing available to companies who would otherwise be forced to retrench to go out of business.

Revenue Ruling 81-216 will have extremely severe consequences for the most vulnerable and some of the most important elements of our country's economy - small businesses and small farms - and we strongly urge its withdrawal.

Thank you for your consideration.

Sincerely,

James R. Thompson
Chairman

JRT:sj

RESOLUTION PROPOSED BY
GOVERNOR CHRISTOPHER S. BOND, MISSOURI

INDUSTRIAL DEVELOPMENT BONDS

Whereas, The United States Treasury Department has announced its intention to issue a regulation denying tax exempt status to multiple lots of industrial development bonds having an aggregate face value of over $1 million if the bonds are: sold at approximately the same time; sold under a common marketing plan; sold at substantially the same rate of interest; and backed by a common or pooled security which is available to pay debt service. The regulation, which will permit 30 days comment and hearings after [illegible] days, would be effective retroactively August 24, 1981-the date of the [illegible] IRS ruling 81-216, which has been withdrawn; and

Whereas, industrial development bonds constitute one of the few economic and community development tools left to the states during this period when federal development assistance programs have been sharply curtailed or eliminated; and

Whereas the lack of capital available to small farms, ranches and businesses and the present high rates of interest have placed many farms, ranches and businesses in severe economic difficulty resulting in high rates of bankruptcy; and

Whereas, the decisions of many employers on whether to make job creating investments in new or expanded plants and facilities are frequently based on the availability of tax-exempt industrial revenue bond financing, the elimination of such a financing tool will mean that many new jobs simply will not be created; and

Whereas, many states in the Southern Governors' Association have adopted or are considering adopting programs to assist small farmers, ranchers and businesses by making available to them the proceeds of $1 million industrial development bonds or agricultural development bonds which have been issued in multiple lots by a state authority; and

Whereas, the proposed Treasury regulation is untimely because it is being issued at a time when the Treasury Department is conducting a comprehensive review of tax exempt bonds and Congress is considering legislation regarding industrial development bonds; and

Whereas, many states have developed these statewide tax exempt bond programs to help small farms, ranches and businesses in reliance upon earlier Treasury Department rulings which are reversed by the proposed regulation;

NOW, THEREFORE, BE IT RESOLVED, that the Southern Governors' Association urges the Treasury Department to withdraw its proposed regulation so that Congress has the opportunity to address the issue of industrial development bonds in an orderly and comprehensive fashion

BE IT FURTHER RESOLVED, that the Southern Governors' Association Congress to enact legislation which will permit the states to continue their tax exempt bond programs to create new industrial jobs and to help small farms, ranches, and businesses in a manner which protects the fiscal integrity of the federal Treasury.

COMMONWEALTH of VIRGINIA
Office of the Governor
Richmond 23219

John N. Dalton
Governor

September 9, 1981

The Honorable Ronald Reagan
The President
The White House
1600 Pennsylvania Avenue
Washington, D. C. 20500

Dear Mr. President:

It has just come to my attention that the Internal Revenue Service on August 24 issued Revenue Ruling 81-216 which will result in disastrous consequences for small farmers and small businesses in Virginia by depriving them of much needed sources of private capital for farmland, equipment, and plant facilities.

This action by IRS does not appear to be in the public interest and is counter to your base philosophy of decreasing the burden of federal regulations on the general public.

In February of 1981, our General Assembly passed legislation creating the Virginia Agricultural Development Authority as an expression of the belief that it is in the public interest to assist the State's industry of agriculture. This industry has experienced unfavorable weather conditions in three of the last five years. At the same time, production costs have increased astronomically without a corresponding increase in commodity prices and even our most efficient and productive farmers are finding it increasingly more difficult to break even financially.

With the sharply diminished role of the FmHA in providing direct or guaranteed loan assistance to farmers, agricultural development bonds have become a viable source of badly needed credit for Virginia's largest single industry which is basic to our economy. The floating interest rate on loans made by the Farm Credit Service -- our principal agriculture lender -- has increased to record high levels.

The Honorable Ronald Reagan
Page Two
September 9, 1981

Agriculture is the basis of the American economy and has been more than pulling its share of the load in our international balance of payments; however, we are not at all sure how long this can continue while agriculture continues in this devastating cost-price squeeze while barely eking out an existence.

We believe the American people, as did our General Assembly in 1981, strongly support the idea of private capital being used to finance agriculture and certain small businesses through the sale of tax exempt bonds. We have been optimistic that this new source of capital would be the help that many of our farmers so badly need and deserve.

We strongly urge you to direct the withdrawal of this ruling which we believe will have extremely severe consequences for a vulnerable but very important segment of this nation's economy -- our small farms and businesses.

With all good wishes, I am

Very truly yours,

John N. Dalton

JND/jhw

cc: The Honorable Donald Regan
The Honorable John Block
The Honorable Roscoe L. Egger, Jr.
Virginia Congressional Delegation
Mr. Rich Williamson

STATE OF MARYLAND
EXECUTIVE DEPARTMENT
ANNAPOLIS, MARYLAND 21404

HARRY HUGHES
GOVERNOR

September 18, 1981

OCT 2 REC'D

SAME LETTER SENT TO: THE HONORABLE PAUL S. SARBANES

The Honorable Charles McC. Mathias, Jr.
United States Senate
358 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator ~~Mathias~~ Mac:

You have recently received a letter signed jointly by your colleagues, Senators Weicker, Durenberger, and Stevens notifying you that they would soon introduce legislation which would delay the implementation of a recent Internal Revenue Service (IRS) Ruling (IR-81-216 dated August 24, 1981). I strongly urge you to support this legislation.

The effect of the IRS ruling is to prevent states from bundling and simultaneously issuing "small-issue" development bonds (IDB) for small businesses and family farms. At this time, Maryland does not have a development bond program for farmers, but the 1981 Maryland General Assembly passed my administration's legislation which created an "umbrella bond" program in the State targeted to small businesses.

It is no secret that interest rates are at record high levels. Access to the tax-exempt bond market can reduce interest cost to borrowers. The "umbrella" bond concept reduces the cost of issuance for the borrowers by spreading those costs among those under the "umbrella."

I am concerned that the problems of capital availability for small businesses will only be exacerbated by this systematic attack on small business. As you know, the Small Business Administration, the Economic Development Administration, and the Farmers Home Administration now have reduced capabilities.

It should also be noted that the Oversight Subcommittee of the House Ways and Means Committee has been reviewing IDB financing and has introduced HR 4420 as a result of that review. I do not support that legislation. However, it seems that the Internal Revenue Service has preempted congressional review with regard to at least the "small-issue" IDBs.

I support congressional review of this matter, and I therefore support the Weicker, Durenberger, and Stevens legislation which would delay implementation of the IRS ruling to give the Congress adequate opportunity to decide the issue.

I would appreciate your assistance in this regard.

Sincerely,

Harry

Governor

EXECUTIVE OFFICE
STATE OF MISSOURI
P.O. BOX 720
JEFFERSON CITY
65102

CHRISTOPHER S. BOND
GOVERNOR

August 27, 1981

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

The Internal Revenue Service has issued a revenue ruling which will result in adverse consequences for the nation's bond market and which will deprive small farmers and small businessmen throughout the country of much needed sources of capital for farm land, equipment and plant facilities. Mr. President, we believe that this action by the Service is in conflict with the public interest; that it is the antithesis of the even-handed and consistent policies which you are trying to urge upon all federal agencies in their treatment of American citizens and American businesses, and that it represents a gross abuse of the tremendous power that is vested in the federal agency responsible for fairly administrating our nation's tax laws.

As governors of states which have made a concerted effort to help small business and small farms, we believe that it is critical that this ruling be withdrawn immediately to avoid any further damage to the already weakened bond markets, to the state and local governments which have been relying upon earlier rulings that this announcement reverses, and to the many small farmers and small businessmen who are dependent upon the sources of credit which this ruling would eliminate.

Specifically, Mr. President, the revenue ruling would eliminate two forms of financing which state governments have developed in recent years and tailored to assist small farmers and small businessmen particularly during the past two to three years when credit has been unaffordable or unavailable. In the first instance, it would eliminate the use of agricultural development bonds, a form of tax-exempt financing by the states to assist small farmers in the acquisition of farm equipment or farm land. A recent Business Week article indicated that on newer farms--farms operated by younger farmers beginning a new enterprise--interest costs have doubled in the past two years to account for as much as 30 percent of their total expenses, wiping out most or all of their profits. A Minnesota banker estimates that up to 12 percent of farmers are at their practical debt limit now and another 10 percent are "hurting." At the end of April, one-third of the FmHA's $20 billion in outstanding loans were in arrears, and the Under Secretary of Agriculture says that "people are going to have to restructure a lot of debt."

With the sharply diminished role of the Farmers Home Administration in providing direct or guaranteed loan assistance to American farmers, agricultural development bonds suddenly have become a viable, and in some areas an exclusive, source of credit to allow small farmers to continue their operations and avoid bankruptcy or having to sell their entire operations. According to an Illinois University professor of agricultural finance, "Many bankers and the farm credit system have been willing to lend to marginal farmers because FmHA stood by to bail them out. Now those lenders will be much less willing to make loans."

Thousands of small businesses also will be deprived of credit because the IRS ruling bars the use of a mechanism developed by the states in which state development agencies put together a package of tax-exempt financing and then make individual loans available to new or expanding small companies. This assistance particularly is aimed at small concerns whose credit would be insufficient to give an individual bond issue a rating which would make it attractive to potential investors. However, when the bond for one small company is grouped together with bonds for a number of other companies, insured credit often is available for the entire transaction making low-cost financing available to companies who would otherwise be forced to retrench or go out of business.

Mr. President, this ruling will have severe consequences for the most vulnerable and some of the most important elements of our country's economy--the small businessman and the small farmer--and we strongly urge you to direct its withdrawal. The Treasury Department and the Congress are in the process of examining the use of industrial development bond financing. If the problems supposedly addressed in the ruling do in fact merit restrictive action, the Congress and the Administration can propose action through legislation. We urge you not to allow the Treasury to impose by regulation, an ill conceived, unduly broad, and potentially disastrous restriction on the states and on American businessmen and farmers.

Sincerely,

CHRISTOPHER S. BOND
Chairman, Committee on Economic
and Community Development
National Governor's Association

CSB:sp

bcc: Governor Richard Snelling
Governor James Rhodes
Governor William Winter
Governor Pierre S. du Pont
Governor John Y. Brown, Jr.
Governor Frank White
Governor Brendan Bryne
Governor James R. Thompson
Governor Paul Calvo
Governor Carlos Romero-Barcelo
Jim Davidson
✓Tom Bash
Don Sipple
Dick King
Chip Casteel
J. H. Frappier
David Broeker

M I F A

Robert E. Patterson
Executive Director

IRS / 81-216

JCM for
[illegible]

SEP 24 1981

September 21, 1981

Steven Farber
Executive Director
National Governors Association
400 North Capital Street, N.W.
Washington, D.C. 20001

RE: Rev. Ruling 81-216

Dear Steve:

I think you should have a copy of the enclosed letter from Governor King to the President regarding a somewhat technical but extremely significant revenue ruling which I know your association has been very concerned about. I have been working with Dave Arnold on this, and I think everyone agrees that regardless of their personal views about industrial revenue bonds, this ruling is no way to deal with the issue.

I would just like to add to our Governor's words that having the ruling rescinded is of the utmost importance to our economic development program. This ruling will have a far greater effect at eliminating reasonably priced expansion capital for smaller companies than would any of the legislative proposals regarding IDBs, including Congressman Rangel's bill. I and the Smaller Business Association of New England have met with Assistant Secretary Chapeton to point out to him the practical effect of the ruling on small business, to no avail.

Please let me know whatever Governor King could do to assist the National Governors Association in its efforts to rescind this very unfortunate ruling.

Best regards,

Robert E. Patterson
Executive Director

REP/pac
Enclosure

Massachusetts Industrial Finance Agency
125 Pearl Street
Boston, Massachusetts 02110
Telephone: 617-451-2477

THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE DEPARTMENT
STATE HOUSE • BOSTON 02133

EDWARD J. KING
GOVERNOR

September 16, 1981

President Ronald W. Reagan
White House
Washington, D.C.

Dear Mr. President:

I would like to express to you my extreme disappointment with Revenue Ruling 81-216 announced by the Internal Revenue Service on August 24th. This ruling will have a devastating effect upon our efforts here in Massachusetts to revive our economy by providing affordable credit to growing small businesses through our industrial revenue bond program.

In the face of rising interest rates and shrinking credit availability for small businesses, these bonds have been an essential source of affordable financing to enable new and growing businesses to invest in productive assets in Massachusetts. This investment has been the source of our recent economic resurgence and of a dramatically lower unemployment rate. Rev. Ruling 81-216 will stop dead the expansion of these companies at a time when smaller companies in particular are suffering from the crushing burden of today's interest rates.

This ruling will effectively close off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible. The ruling will freeze smaller companies out of the national credit markets during a very difficult financial period.

Rev. Ruling 81-216 was announced without notice, and without the opportunity for public comment which a regulation would have provided. It represents a dramatic reversal of prior IRS policy. In fact, it expressly revokes three prior rulings upon which my state has relied while preparing an innovative program to give smaller companies access to the national credit markets. Our program had been announced to the state's banking community. Many of our banks and companies were basing important financial plans on this new program, which was clearly legal under these long-standing rulings now suddenly reversed by the IRS.

Unless Rev. Ruling 81-216 is revoked, it will be impossible for smaller companies to obtain capital from the national credit markets pursuant to the federal law governing industrial revenue bonds. With this ruling the IRS has arbitrarily overruled Congress' explicit favoring of smaller projects and companies for industrial revenue bond financing.

It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral (insurance or bank letters of credit). It is bad enough that these companies must pay higher rates to purchase the collateral they need to buy access to the national debt markets. It is unacceptable, however, that the IRS with Rev. Ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased.

At a time when federalism is being given a new lease on life and our nation's policies are focusing on economic revitalization, it is puzzling to see the IRS abruptly halt the efforts of many states to provide reasonably priced capital for smaller companies and farmers adding productive assets and creating new jobs.

As the Governor of a long-distressed state which recently has made business growth the cornerstone of its program, I urge you to reverse this ill-conceived ruling which changes the rules in the middle of the game with no prior notice to anyone and will have disastrous consequences to smaller businesses.

Thank you for your consideration.

Sincerely,

Edward J. King

Edward J. King
Governor

EJK:pjp

kdfa
Kentucky Development Finance Authority

M E M O R A N D U M

TO: Jim Martin and Bill Bivens
National Governors Association

FROM: Roger L. Peterman
Executive Director

SUBJECT: Revenue Ruling 81-216

DATE: September 30, 1981

During times of high interest rates the first to suffer are the small businessman and the small family farmer. The severe problems are due to limited sources of revenue and to the high percentage of overall costs that interest rates represent. From an economic development viewpoint this problem is quite serious, since small business generates the greatest number of new jobs. High interest rates not only prevent these individuals from expanding into new production areas or modernizing, but in a very real sense pose the threat of insolvency. Unfortunately, the Internal Revenue Service has compounded the problem through Revenue Ruling 81-216.

The Commonwealth of Kentucky has attempted to establish methods of making low interest rate money available to the small businessman and farmer through tax-exempt financing. The only way to make small, tax-exempt, loans is by combining a number of loans into a single industrial development bond issue. Loans can only be combined into single issues by using one common underlying credit for all the loans. Kentucky has explored the possibility of using federal guarantee programs, state guarantee programs, and private sector guarantees to provide the underlying credit. In one instance a program was promoted to the financial community and was very well received, only to be eliminated by Revenue Ruling 81-216.

The best interests of Kentucky and the Nation are served by the small businessman and farmer. The counter-cyclical nature of tax-exempt financing is an efficient way of providing assistance during these difficult times. It is unfortunate that the Internal Revenue Service has adopted a policy that virtually prohibits tax-exempt financing for the small businessman. We urge Congress and the Small Business Committee to take whatever action is necessary to reverse the effect of Revenue Ruling 81-216.

RLP/tm

cc: Senator Huddleston

24th Floor, Capital Plaza Tower, Frankfort, Kentucky 40601 (502) 564-4554

Mr. SNELLING. I would also tell you that they will be surveying the Governors for their comments on the regulations and making that information available to you.

I would just close by pointing out that the Governors have been very cooperative with the thrust of the President's recommendations to the Congress for making essential changes, both in budget and in regulatory mechanisms.

However, many of these things are mutually dependent if we are to lose the kind of assistance which has been available through EDA grants and programs in the past of the Department of Commerce, and we stand very clearly to lose those, then the mechanisms which spring from our own constitutional authority must be inviolate.

I am not a lawyer, but it does strike me that historically States have had, because that right preexists in many ways in the Constitution of the United States, the right to determine which of their financial entities shall be tax exempt.

If in this particular period when we are trying to transition to a private non-Federal approach to the solution to many problems, as compared to the Federal approach, we must not strip away one capacity and then simultaneously strip away its alternative.

We are very pleased at your actions, and we do hope that we can continue to assist you in preventing this ruling, which we consider to be arbitrary and self-defeating.

Senator D'AMATO. Governor, let me assure you that we need your help and will be calling upon you and our colleague, Senator Stafford.

We had Senator Stevens testify today.

At the risk of sounding a little harsh perhaps and not really familiar with all the nuances of the various diplomatic language used in the Senate in expressing one's displeasure, I am almost in total disbelief at the arrogance of the executive branch which now looks to totally eclipse legislative—not only prerogative—obligation under the Constitition of the United States.

I always thought that there were three different branches. Not having been a history major, I still remember something about checks and balances.

I see a Treasury Department that would not even deign to send a representative here today, unless there is someone here unofficially, to take an official position, to explain to this committee, to the American people, to the Governors and to the local officials who have come here from the length and breadth of this great Nation, why they feel Revenue Rule 82-216 is proper.

Senator STAFFORD. Mr. Chairman, I think you are learning the language of the Senate very rapidly. [Laughter.]

Senator D'AMATO. Senator Dixon?

Senator DIXON. I want to say how much we appreciate your coming here, Governor.

My Governor, Jim Thompson, is very supportive of the views you have expressed here.

Mr. Chairman, this morning I received a letter from the distinguished Governor of the State of Illinois, Governor Thompson, expressing his concern about Treasury's revenue ruling, and their future action with respect to tax-exempt IDB's. In addition, he has provided me with an impressive analysis of the utilization of IDB's in Illinois, and the benefits which their use has brought our State. I would ask that this material be inserted in the record.

[Material follows:]

State of Illinois,
Office of the Governor,
Chicago, Ill., October 2, 1981.

Hon. Alan J. Dixon,
U.S. Senate,
Washington, D.C.

Dear Alan: I want to thank you for your recent efforts to preserve the ability of Illinois governments to promote economic development through the use of industrial development bonds (IDB's). I understand that you have joined in sponsoring S. 1635 which would postpone the effective date of Revenue Ruling 81-216 until such time as the Congress can evaluate the implications of this major change in policy.

As you know, Revenue Ruling 81-216 would have precipitously eliminated issuance of both agriculture bonds and multiple lots of $1,000,000 revenue bonds. These types of bonds are extremely important to small businesses and farmers in the current economic environment. On September 1, I sent a letter to the President on behalf of the Midwestern Governors' Conference requesting that the Administration reconsider their sudden change in policy. Attached is a copy of that letter which outlines the importance of these types of bonds to the Midwest.

I now understand that our concerns have been heard and that next week the Treasury will be providing for a hearing and comment period on a proposed rule which will be substituted for the revenue ruling. This opportunity to comment is important and I believe that your committee hearing on October 5, should contribute to convincing the Administration to reconsider its intentions.

In addition to the immediate concern we have had over Revenue Ruling 81-216, we have also been aware of Congressional consideration of proposals to severely restrict or terminate tax-exempt bonding for development purposes. IDB's have been a cornerstone of Illinois' industrial expansion efforts and the loss of this tool would severely restrict our ability to create jobs in Illinois. IDB's have been a particularly useful incentive in our efforts to attract overseas investment to Illinois.

The attached sheets outline the benefits of IDB's in Illinois. We believe that IDB's actually bring in more in new taxes than they cost in lost revenue. I urge you and your colleagues to study this material since I believe it will help convince you of the irreplaceable value of IDB's to job creation.

I hope that this information will be useful to you and that your efforts on behalf of Illinois will be successful.

Best wishes.

Sincerely,

James R. Thompson,
Governor.

Attachments.

September 1, 1981.

The President,
The White House,
Washington, D.C.

Dear Mr. President: The Midwestern Governors have asked me to convey to you our deep concerns about the implications of Internal Revenue Service Revenue Ruling 81-216. This ruling prohibits issuance of multiple lots of $1,000,000 revenue bonds and eliminates tax exempt financing to assist small farmers. The ruling will have the effect of depriving small farmers and small businesses of much needed sources of capital for farmland, equipment and plant facilities.

As Governors of states which have made a concerted effort to help small businesses and small farms, we believe that this ruling should be withdrawn. State and local governments have been relying in good faith upon earlier rulings which this announcement reverses, as have many small farmers and small businessmen who are dependent upon the sources of credit which this ruling would eliminate. Hundreds of millions of dollars are involved nationwide in the various loan programs which will be jeopardized by this ruling.

Specifically, the Revenue Ruling would eliminate two forms of financing which state governments have developed and tailored to assist small farmers and small businessmen particularly during the past two to three years when credit has been unaffordable or unavailable.

In the first instance, it would eliminate the use of agricultural development bonds, a form of tax-exempt financing used by the states to assist small farmers in the acquisition of farm equipment or farmland. With the sharply diminished role of the FmHA in providing direct or guaranteed loan assistance to American farmers, agricultural development bonds have become an important, and in some areas an exclusive, source of credit to allow small farmers to continue their operations.

Thousands of small businesses also will be deprived of credit because the IRS ruling bars the use of a mechanism developed by the states in which state development agencies put together a package of tax-exempt financing and then make individual loans available to new or expanding small companies. This assistance is aimed at small concerns whose credit would be insufficient to give an individual bond issue a rating which would make it attractive to potential investors. However, when the bond for one small company is grouped together with bonds for a number of other companies, insured credit often is available for the entire transaction, making low-cost financing available to companies who would otherwise be forced to retrench to go out of business.

Revenue Ruling 81-216 will have extremely severe consequences for the most vulnerable and some of the most important elements of our country's economy—small businesses and small farms—and we strongly urge its withdrawal.

Thank you for your consideration.

Sincerely,

JAMES R. THOMPSON,
Chairman.

ILLINOIS SUMMARY/ANALYSIS OF IRB BONDS ISSUES, JANUARY 1973 to JULY 1980

Year	Number of bonds issued[1]	Amount	Number of bonds issued[2]	Amount	Total number of bonds	Total amount
1973	17	$43,005,000	1	$6,450,000	18	$49,455,000
1974	25	152,925,000	5	56,505,000	30	209,430,000
1975	17	23,035,000	6	93,000,000	23	116,035,000
1976	31	115,782,500	5	25,882,000	36	141,664,500
1977	28	32,910,000	12	152,235,000	40	185,145,000
1978	29	141,509,000	10	53,510,000	39	195,019,000
1979	21	42,420,000	8	120,650,000	29	163,070,000
1980	18	16,208,500	21	64,425,000	39	30,633,000
Given	4	8,250,000			4	8,250,000
Total for 8 yrs	190	576,045,000	68	572,657,000	258	1,148,702,000

[1] By communities and counties.
[2] By noncommunities.

Note.—Through July 1980 only.

SOURCE OF IRB'S ISSUED, JANUARY 1973 TO JULY 1980

Issuer	Number of issuers	Number of bonds issued	Amount
Communities/counties	120	190	$576,045,000
Greater Rockford airport authority	1	2	1,750,000
Seneca regional port district	1	1	2,550,000
Illinois environmental facilities financing authority	1	59	562,897,000
Illinois industrial development authority	1	6	5,460,000
Total	106	258	1,148,702,000

IMPACT OF TAX FREE BOND ISSUES

Memorandums of agreement approved	Amount of issue ×	Interest rate =	Interest total	Anticipated new jobs =	New Federal income taxes
Alden Press	$1,000,000	6.75	$67,500	45	$93,633
Dyckerhoff & Widmann	800,000	6.75	54,000	6	12,484
Coal Age Service Corp.	500,000	10.5	52,500	39	81,148
Vanguard Tool	660,000	10.0	66,000	45	93,633
LaSalle Manufacturing	1,500,000	[1] 9.5	142,500	40	83,229
Modern Drop Forge	4,000,000	[1] 9.5	380,000	40	83,229
Carter Lumber	1,000,000	[1] 9.5	95,000	75	156,055
Forms Corp. of America	1,750,000	[1] 9.5	166,250	15	31,211
Total	11,210,000		1,023,750	305	634,622

[1] These interest rates are projected, not actual.

According to information we received, all banks are in the maximum tax bracket of 46 percent. Based on this rate, the $1,023,750 interest would generate $470,925 in Federal taxes. However, based on projected employment of 305 at an average industrial wage (Illinois, January 1981) of $17,784 annually, $634,622 will be generated in Federal individual income taxes, $163,697 more than would be payable if IRB's were not tax free.

We used the above figures to find the "average" project. This is outlined below.
Project: $1,401,250 (11,210,000—8)
Interest Rate: 9 percent
Industrial Wage: $17,784 Annually
Individual Federal Income Taxes: $2,081 Annually[1]
Jobs Created: 38 (305÷8)
Total Annual Wages: $675,792 (38 Jobs ×$17,784)
Federal Income Taxes: $79,078 (38×$2,081)
Tax Free Interest: $126,112.50 ($1,401,205×9 percent)
Federal Taxes Generated if IRBs were Taxed: $58,012
Increase in Federal Taxes Generated by New Jobs: $21,066 ($79,078 Individual Federal Income Tax less $58,012 Corp. Federal Tax on Banks)

Senator **Dixon**. I would hope that your conference would recommend to the individual Governors that they each go to the trouble of writing their two Senators and House Members and the congressional delegation to urge upon them support for what we intend to do here.

Mr. **Snelling**. Yes, sir; we will do that.

Senator **Dixon**. Thank you very much for coming.

Senator **D'Amato**. Governor, thank you so very much for taking your time and effort to express your concern and support.

We look forward to working with you on this.

Mr. **Snelling**. Thank you for hearing me.

Senator **D'Amato**. The committee stands in recess. We will continue to hold the record open to receive additional testimony.

[Whereupon, at 12 p.m., the subcommittee recessed, to reconvene subject to call of the Chair.]

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[1] Average tax rate in Illinois for gross income ($16,000 to $18,000) is 11.4 percent.

Source: Illinois Industrial Development Authority and Department of Commerce and Community Affairs.

APPENDIX

International Council of Shopping Centers
665 Fifth Avenue
New York, N.Y. 10022
212/421-8181

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*Past President

STATEMENT OF

THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

ON

"SMALL-ISSUE" INDUSTRIAL REVENUE BONDS

SUBMITTED TO

THE URBAN AND RURAL ECONOMIC SUBCOMMITTEE

OF

THE SELECT COMMITTEE ON SMALL BUSINESS

OF THE

UNITED STATES SENATE

OCTOBER 5, 1981

Contact: Edward J. Sack
General Counsel

TABLE OF CONTENTS

Page

SUMMARY OF STATEMENT

STATEMENT

I. Introduction 1

II. The Role of Industrial Revenue Bonds in Shopping Center Development 2

III. Economic Benefits of Shopping Center Development 3

Employment 4

Tax Revenues 5

IV. Federal Tax Revenue Impact of Small-Issue Industrial Revenue Bond Financing 10

V. Legitimate Criteria for Evaluation of the Tax Exempt Status of Small-Issue Industrial Revenue Bonds 13

VI. Recommendations 14

SUMMARY OF STATEMENT

The members of the International Council of Shopping Centers believe that the tax-exempt status afforded small-issue industrial revenue bonds has allowed shopping centers and other retail facilities to be built in communities that would otherwise remain without the clear economic benefits directly attributable to those facilities. These benefits include increased employment (with accompanying increases in associated employment and personal income tax revenues) and increased local and state revenues from real estate, sales, and other taxes generated by the retail centers.

Many of the shopping centers that are being built today and that are producing these economic benefits would not have been built, in light of present market conditions, without the assistance of industrial revenue bond financing. Compared with the economic benefits resulting from retail facilities, and produced by IRB financing, the costs in federal tax revenues resulting from the tax exemptions afforded interest on industrial revenue bonds are minimal or nonexistent.

The ICSC opposes efforts to restrict, at the federal level, the future availability of industrial revenue bond financing for commercial or industrial development.

STATEMENT OF
THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS
ON
"SMALL-ISSUE" INDUSTRIAL REVENUE BONDS
PRESENTED TO
THE URBAN AND RURAL ECONOMIC SUBCOMMITTEE
OF
THE SELECT COMMITTEE ON SMALL BUSINESS
OF THE
UNITED STATES SENATE
OCTOBER 5, 1981

I. INTRODUCTION

The International Council of Shopping Centers (ICSC) is a business association of approximately 10,000 members consisting of shopping center developers, owners, operators, tenants, lenders and related enterprises. ICSC represents a majority of the 22,000 shopping centers in the United States.

It is estimated that more than 5.9 million people are regularly employed in shopping centers and that several hundred thousand more are annually engaged in new construction. The rippling effect of shopping center development on employment in related businesses, including display advertising, maintenance and cleaning, legal and accounting, and the manufacture of goods sold in the centers, is considerable.

It is estimated that in 1980 shopping centers accounted for 41 percent of total U.S. retail sales. By the beginning of the next decade (1990), the shopping center share will likely range between 48 percent and 53 percent. In current dollar value, U.S. shopping center retail sales reached a level of $386 billion in 1980.

Clearly, the retail store and shopping center industry has a significant influence on the total United States economy.

II. THE ROLE OF INDUSTRIAL REVENUE BONDS IN SHOPPING CENTER DEVELOPMENT

As with other construction industries, shopping center development has in the past been dependent upon leveraged financing. Present market conditions have by and large dictated what we hope will prove to be a temporary end to conventional financing, and, therefore, a temporary end to conventionally financed shopping centers.

The ICSC submits that the availability of industrial revenue bond financing, with the limited tax exemption afforded under Internal Revenue Code §103(b), has allowed shopping centers and other commercial facilities to be built in communities that would otherwise remain without the clear economic benefits directly attributable to those retail facilities.

One example of such a facility is a shopping center of 175,000 square feet of gross leasable area that was developed near Altoona, Pennsylvania in 1975. It is not a grand enclosed mall with major department stores; it is a simple, small center with a discount department store, a supermarket, three restaurants, a four-screen cinema, and twelve additional tenants in a relatively small amount of space. By November 1978, the tenants of this shopping center employed approximately 300 persons. Yet this project, with its $3.5 billion construction contract, almost didn't get built. During the year-long planning phase of the project, mortgage interest rates available for conventionally financed shopping centers rose from about 7 1/2 percent to almost 10 percent. At that higher interest rate, it would have been impossible for projected rents to support the debt service on the proposed shopping center. The project went forward only after IRB financing made it possible for the developer to obtain a commitment for permanent financing at 8 1/4 percent.

This shopping center, and many more like it, would have gone unbuilt but for the capital resources made possible (or at least more accessible) through IRB financing. The ICSC believes that the communities served by these facilities are economically better off today than they would have been without them.

III. ECONOMIC BENEFITS OF SHOPPING CENTER DEVELOPMENT

The extent of the contribution of shopping center development to the nation's productivity is not fully understood. Many people think of productivity solely in terms of the process leading directly to the manufacture of goods. Others would broaden the concept enough to include the distribution of those goods to the loading docks of the nation's retail facilities--but not to the distribution of products to the ultimate consumer. The fact is, of course, that retail facilities, as the final link in the chain of distribution, are an integral part of the productive process.

Furthermore, shopping centers generate jobs and significant municipal revenues in a number of ways. Sales taxes and real property taxes are two of the largest sources of state and local revenue attributable to shopping centers. Other direct contributions to local treasuries include business license revenues and personal property taxes on such things as office and retail equipment and inventories. Of course, increased employment in the construction and operation of a shopping center represents a very tangible benefit to the community.

Employment. The ICSC has estimated that the tenants of shopping centers employ one full-time employee for every 400 to 500 square feet of gross leasable area space. Thus, the Altoona shopping center of 175,000 square feet described above employs 300 people. Many of these 300 people, as recent entrants into the job market, would have been unemployable or marginally employable in industrial positions.

Furthermore, figures compiled by the New Jersey Economic Development Administration demonstrate that, at least in that state, IRB financing for commercial projects is a more effective means of creating permanent jobs than all other uses of IRB financing. As figure 1 indicates, the number of permanent jobs created per $1.0 million of industrial revenue bond financing for commercial projects (including retail facilities) was approximately one-third higher than the number of industrial jobs generated by the same dollar amount of IRBs.

Figure 1.

Project Type	Total New Jobs* 1980	Total 1980 Industrial Revenue Bonds Issued in Support of Projects ($000)	New Permanent Jobs per $1.0 Million of IRBs
Commercial (including retail)	1,613	$ 52,181.1	30.9
Balance of Projects, Excluding Office and Investment in Quasi-Public Utilities	11,131	$478,334.4	23.3

*Permanent (excludes construction).

Source: New Jersey Economic Development Administration, 1980 Annual Report 15-21.

Tax Revenues. It is difficult to dismiss the economic impact of shopping center development in local communities when one looks beyond abstract projections of sales tax revenues and the like and considers the empirical data on the actual performance of shopping centers. For example, a 1975 study published by ICSC included a twelve-year case history of the fiscal impact of a large shopping center in Oak Brook, Illinois.

The Oakbrook Regional Shopping Center is no more typical of the diverse facilities developed by ICSC members than any one shopping center can be. Nevertheless, the Oakbrook study suggests generally the powerful fiscal influence shopping centers can exert.

During the period from 1963 through 1973, the Oakbrook shopping center was the primary source of sales tax revenue for the Village of Oak Brook, Illinois. The shopping center's share of total municipal revenues ranged from a high of 91.3 percent in 1965 to 75.4 in 1973 (the last year for which the study developed data). Even after taking into account the increase in municipal tax expenditures attributable to the shopping center's presence in Oak Brook (for example, increased police and fire protection and local road maintenance), the ICSC study found that in 1973 Oak Brook received net cash-flow benefits in excess of $1.2 million directly attributable to the shopping center. Without this net revenue source, the report concludes, "Oak Brook would have had a deficit which would require either a decrease in expenditures or another income source. Current studies conducted by the village further indicate that a property tax will not be required until at least 1980. However, without the shopping center such a tax probably would have been mandated by 1973 or 1974 if current levels of municipal expenditures were maintained."1/

Although the Oakbrook Regional Shopping Center was built without the assistance of IRB financing, it was built at a time when market conditions made such financing unnecessary. Today's developer of retail facilities is not so fortunate.

1/ Levin, Measuring the Fiscal Impact of a Shopping Center on its Community 30. International Council of Shopping Centers, 1975.

For example, ICSC member M.H. Hausman Co., an Ohio developer of commercial facilities, has built two shopping centers in the past year with industrial revenue bond financing. The company reports that neither of these facilities would have been built if the sole financing method available to the company had been conventional mortgages with the prevailing interest rates of 14 to 15 percent.

A quick review of the income and expenses associated with one of M.H. Hausman's shopping centers illustrates why such a conclusion is inevitable. The company's Columbia-Detroit shopping center in Westlake, Ohio, comprising some 50,000 square feet of gross leasable area, was financed through a $2.0 million IRB mortgage bearing an interest rate of 7 1/2 percent.

As figure 2 shows, the annual debt service of $181,632 on the mortgage, combined with general and miscellaneous expenses, yields a net annual cash flow to the shopping center owner, after deduction from rental income, of $34,197. A 14 percent mortgage, on the other hand, would result in an annual debt service of approximately $289,000. That mortgage expense would, even with all other expenses remaining the same, produce an annual loss in excess of $74,000, and would therefore have dictated that the Columbia-Detroit shopping center not be built.

Figure 2.

	IRB Financing		Conventional Mortgage Financing	
INCOME				
Fixed Rent		$220,176		$220,176
EXPENSE				
Mortgage	$181,632[a]		$289,000[b]	
General Expense-Net Recovery	3,800		3,800	
Miscellaneous Expense	2,400	187,832	2,400	295,200
Net Cash Flow (Loss)		$ 34,197		$(74,824)

[a] $2,000,000 principal amount, 7 1/2 percent interest, 24 year term.
[b] $2,000,000 principal amount, 14 percent interest, 25 year term.

A similar analysis of income and expenses for the second of M.H. Hausman Co.'s IRB-financed projects reflects the same devastating effect of high mortgage interest rates. The company estimates that, when completed later this year, its Crossroads Plaza in Saybrook, Ohio, with more than 70,000 square feet of gross leasable area, will produce a net cash flow of $39,358. Replacement of the 7 1/2 percent IRB-backed mortgage with a 14 percent mortgage would transform that figure into a net loss of $115,442 per year.

Of course, it might be argued that these illustrations show nothing more than that present market conditions justify higher rents to offset a developer's rising mortgage costs. As a practical matter, however, tenants of retail facilities are strictly limited in their ability to bear the burden of increasing financing costs.

In deciding whether or not to lease space in a proposed shopping center, prospective tenants invariably focus on their projected return on investment. Although methods vary from one retailer to the next, analyses of returns on investment consider such factors as the estimated sales in the proposed facility, the expense of doing business, the anticipated profit, and a comparison of that profit to the total investment to be made in the new facility.

Clearly, rent is an important component of a tenant's expense of doing business. Thus, a proposed shopping center that cannot keep lease payments within the range required by a prospective tenant's return-on-investment analysis will not get built or will be delayed until interest rates fall to a level that will allow for rents which will permit the retailer to operate at a profit.

In the interim, people who could have been working will not be working, personal and business income taxes that could have been collected will not be collected, state and local taxes that could have been collected will not be collected, and so on.

The ICSC believes that these illustrations are typical of the conditions existing throughout the industry. The net effect, therefore, of eliminating or reducing the availability of small-issue IRB financing for retail facilities will be a substantial reduction of new construction starts in retail facilities. Concomitant with that reduction will be the loss to local treasuries of significant tax revenues. For example, the two relatively small shopping centers built by M.H. Hausman Co. discussed above are expected to generate total combined real estate and sales taxes of approximately $67,000 per year at full occupancy. Of course, that $67,000 is calculated without regard to the very significant local revenues arising out of increased employment (estimated at 250 to 300 new jobs) and the secondary development that may be spurred by the introduction of the new retail facilities.

The ICSC believes that IRB financing provides developers of shopping centers and other retail facilities with an opportunity that might not otherwise exist to increase the quality of life in local communities in at least as efficient and effective a manner as the IRB financing of industrial facilities.

IV. FEDERAL TAX REVENUE IMPACT OF SMALL-ISSUE INDUSTRIAL REVENUE BOND FINANCING

It is clear from the Congressional Budget Office study released in April of this year that the CBO does not share the ICSC's enthusiastic outlook on the economic benefits to be derived from small-issue industrial revenue bond financing. The CBO asserts that the net revenue gain to be derived from elimination of the tax exemption for such IRBs would total $2.5 billion over fiscal years 1981 through 1986.

A study prepared last year by economist Norman B. Ture reaches conclusions that stand in marked contrast to those of the CBO. In the course of his study, Ture considered the extent to which federal tax revenues would be affected by the elimination of the tax exemption for small-issue IRBs. According to Ture,

> there are two ways of measuring changes in the Federal tax revenues in response to a change in the law. Initial impact estimates measure returns under the unrealistic assumption that there are no changes in economic activity in response to the tax change. On this assumption, the volume of private investment is unaffected by the amount of IDBs issued, implying that each additional dollar of IDB-financed investment displaces a dollar of taxable bond--or equity--financed capital outlay. On this basis there would be a slight revenue loss--less than $50 million--in 1989. If the amount of IDBs were deemed to be associated with additional investment--that is with investment which otherwise would not be undertaken--the initial impact revenue effect would be zero, since no displacement of other financing, by hypothesis, would have occurred. The alternative net-of-feedback measure takes into account changes in economic activity in response to the tax change and the effects of these changes in the economy on tax bases. In this instance, additional IDB financing results in net additions to the volume of capital formation, rather than displacement of taxable-bond-financed investment. As shown, this additional investment leads to gains in output and income.2/

Clearly, the experiences of ICSC's membership bear out Dr. Ture's conclusion that "IDBs are productive instruments for promoting economic development by making saving and investment more attractive to individuals and businesses. Their use results

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2/ N. Ture, A Report Prepared for the National Committee on Small Issue Industrial Development Bonds: Economic and Federal Revenue Effects of changes in the Small Issue Industrial Bond Provisions 10 (1980) (emphasis added).

in overall gains in capital formation, employment, and output, rather than merely changes in the location of economic activity."[3] Finally, Ture recommends, and the ICSC supports him in his recommendation, that the existing $10 million capital expenditure limit be raised to increase the number of projects eligible for IRB financing, an action that would "expand total capital outlays, employment, and real GNP."[4]

In testimony before the Oversight Subcommittee of the House Ways and Means Committee on April 8, 1981, Roger C. Kormendi of the University of Chicago challenged certain assumptions upon which the CBO based its estimates of the net loss to the federal treasury associated with IRBs. Kormendi, in a report prepared with Thomas T. Nagle, concluded that

> the cost of IDB financing in foregone federal tax revenues is on the order of $4 to $6 million... for each billion dollars of new IDBs when taxable interest rates are in a range of 10% to 14%. These estimates contrast sharply with the CBO's recent estimates of $30 to $40 million for each billion dollars of bonds.[5]

Furthermore, according to Kormendi and Nagle, their estimates of revenue loss

> imply that each dollar of interest saving for IDB borrowers costs the U.S. Treasury approximately 15 cents in federal tax revenues. Thus IDBs are more than six times as efficient as direct subsidies, which cost the U.S. Treasury one dollar

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[3] *Id.* at 11.
[4] *Id.* at 11-12.
[5] R. Kormendi and T. Nagle, A Summary of the Nature and Effect of Small-Issue Industrial Development Bonds 1 (1981).

> for each dollar of benefit. This conclusion contrasts sharply with the Treasury's claim that each new dollar of interest saving for IDB borrowers costs the U.S. Treasury $1.33 in federal tax revenues.6/

It is important to note that these estimates of revenue loss are not, as Ture would say, "net-of-feedback." Kormendi and Nagle point out that

> Tax revenues depend not only on tax rates but also on the tax base. Anything that encourages the tax base to expand will result in a higher feasible level of tax revenues in the future. The lower capital cost provided by the interest tax exemption will almost certainly lead to more investment and growth of the small business sector (and it certainly will not result in less growth). Hence, sales, property, and income tax revenues are likely to grow concomitantly. Therefore, the tax revenue loss we have estimated can only be an upper bound.7/

If nothing else, the views expressed by Ture, Kormendi and Nagle suggest the need for caution in analyzing the economic effects of industrial revenue bonds.

V. LEGITIMATE CRITERIA FOR EVALUATION OF THE TAX EXEMPT STATUS OF SMALL-ISSUE INDUSTRIAL REVENUE BONDS

The ICSC would argue that any decision to preserve or eliminate the tax exemption for small-issue industrial revenues should be made solely on economic merit. The ICSC membership is satisfied that a legitimate cost-benefit analysis, considering

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6/ Id.
7/ R. Kormendi and T. Nagle, The Nature and Effects of Small-Issue Industrial Development Bonds 55-56 (March 30, 1981).

all issues relevant to ultimate impact on the national economy, would dictate not only the preservation, but the expansion, of the present tax exemption.

If it is correct that minimal or no net loss to the federal treasury arises from the availability of small-issue IRB financing, no other legitimate policy consideration would be served by curtailing access to that source of capital. At the very least, it would be inappropriate for IRB critics to pursue some hidden philosophical goals, whatever those may be, disguised as a legitimate effort to reduce federal budget expenditures.

Moreover, the CBO's recent study reflects the diverse criteria among states for the appropriate uses of IRBs within their borders. So long as the federal interest in governing IRB use is as minimal as the net effect of IRBs on the federal treasury, ICSC believes that the federal government should decline to engage in efforts to impose uniformity on the states' exercise of their authority to issue IRBs. If individual communities and states, as major benefactors of the increased revenues attributable to commercial development, choose to encourage particular types of commercial and industrial development, their will need not and should not be supplanted.

VI. RECOMMENDATIONS

It is clear, both from the CBO's acknowledgment of the inadequate data underlying its recent report and from the ICSC's own efforts to develop comprehensive information on the use of IRBs, that Congress cannot now be fully informed on the economic merits of IRB financing. The ICSC therefore recommends that reporting requirements be imposed at the state level on all users of industrial revenue bonds. As a condition of continuing the tax exemption of Internal Revenue Code §103(b), lenders could, for example, be required to report annually information on the amounts of IRB financing provided; the number of jobs created per million dollars of IRB issuance; wages, FICA taxes, and federal, state and local income taxes associated with these jobs; and property taxes and sales taxes generated by IRB-financed projects.

The membership of the ICSC offers a general recommendation that Congress encourage the greater use of IRBs, whether through increased capital expenditure limits or other means, to finance commercial and industrial projects.

ICSC also submits that certain provisions of Internal Revenue Code §103(b) have imposed inequitable and unnecessary conditions on the availability of IRB financing. The current $10 million capital expenditure limit applies, under §103(b), to all facilities that are (1) located in the same municipality or county and (2) associated with the same principal user or users.[8/]

The first of these criteria, the jurisdictional limitation of §103(b), should be modified to allow additional capital expenditures for industrial or commercial projects in areas where higher population would suggest a greater demand for those

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[8/] I.R.C. §103(b)(6)(E).

projects. The ICSC recommends, therefore, that the Congress respond to the needs of those populous communities by permitting higher capital expenditure limits in jurisdictions where population levels exceed a specified level.

Memphis Area Chamber of Commerce

October 2, 1981

The Honorable Alfonse M. D'Amato
United States Senate
Washington, D.C.

As Executive Vice President of the Memphis Area Chamber of Commerce I am extremely pleased to have this opportunity to comment upon current proposals to restrict or eliminate the business finance incentives currently available through use of Industrial Revenue Bonds.

Unlike many communities, Memphis only recently began to take advantage of the Industrial Revenue Bond vehicle. As a community we had had many of the concerns now being expressed on a national basis about possible abuses of such bonds. As a result, when the local Industrial Development Board was formed, strict guidelines were set up to insure that the bonds would only be used for productive capital investment. A copy of the Statement of Intent of our local Industrial Development Board is attached to demonstrate the types of restrictions which were determined to be appropriate on a local basis. Also attached are the separate application procedures of our Center City Industry Development Board, demonstrating use of the bonds in connection with our urban redevelopment activities.

As a result of the responsible position taken by our local Industrial Development Board, Memphis' experience with bond financing has been extremely positive. Through the use of local property tax incentives as well as bond financing, we have been able to spark a resurgence in our formerly deteriorating downtown area, including construction of numerous housing and commercial buildings as well as renovation of the Peabody Hotel which has now been restored to its former position at the heart of our downtown. We have also been able to provide badly needed business capital funds for expanding local industry, creating hudreds of new jobs, many filled by previously underemployed individuals.

As a result, current proposals to restrict or eliminate entirely this form of financial incentive cause a great deal of concern to those of us charged with the job of promoting the development of Memphis. Memphis, unlike certain of the other "sunbelt" cities, continues to rank among the poorest in America. Approximately forty percent (40%) of our population is black, and a large percentage of this group, as well as a large percentage of our white population, suffers from unemployment or underemployment. Social services cutbacks already adopted, as well as those currently being proposed, are likely to make this situation worse, not better.

P. O. Box 224, Memphis, Tennessee 38101 901 523-2322

The Honorable Alfonse M. D'Amato
October 2, 1981
Page Two

Accordingly, we in the Memphis community have concluded that the best hope for improving the plight of our economically disadvantaged citizens is to promote an agressive campaign of economic and urban development. Availability of business capital is a critical factor in this program. While big business generally has no problem with finding capital (although its price may be high), smaller business, such as we depend upon in Memphis, can often find no capital whatsoever. The availability of industrial revenue bond financing is a bright spot in an otherwise bleak picture for many of our local concerns.

We would ask that, in considering amendments or restrictions to reduce the costs to the U.S. Treasury of various forms of industrial revenue bond financing, you not lose sight of those areas where a real public purpose exists for this form of financing: i.e., provision of capital funds for the smaller business and provision of financial incentives for redevelopment of economically disadvantaged urban areas.

One matter of specific concern relates to the "Rangel Bill" (H.R. 4420) now being considered by the House of Representatives. This bill is designed to restrict use of industrial revenue bond financing for "commercial-type property" to economically distressed areas, a concept with which we have no problems in the city of Memphis. However, the specific language of the bill is such that commercial-type property is defined to include standard industrial classification code division F-Wholesale Trade. This includes distribution centers and commercial warehouses, possibly even where attached to manufacturing facilities.

For a city such as Memphis this creates a major problem in that much of our economic base depends upon the wholesale and distribution industries. From matters of physical convenience, such distribution facilities must often be located in the newer areas of our community, nearer the expressways and other transportation facilities. These areas are normally not the "economically distressed areas" of the Memphis community, but the facilities constructed for these industries result in the creation of many jobs for the unemployed and underemployed segments of our community. Thus we ask that in considering any bill to restrict use of industrial revenue bond financing for commercial facilities, you define such facilities in such a way as to exclude the wholesale or industrial distribution activities, which are so important to our local economy.

Memphis Area Chamber of Commerce

The Honorable Alfonse M. D'Amato
October 2, 1981
Page Three

We would appreciate your giving careful consideration of the concerns of the Memphis community in this area and would be pleased to provide further information to you or your committee as appropriate.

Sincerely yours,

C. Tiffany Bingham, Jr.
Executive Vice President

P. O. Box 224, Memphis, Tennessee 38101 901 523-2322

STATEMENT OF INTENT

THE INDUSTRIAL DEVELOPMENT BOARD
OF THE CITY OF MEMPHIS AND
COUNTY OF SHELBY, TENNESSEE

(December, 1979 Revision)

The Industrial Development Board of the City of Memphis and County of Shelby, Tennessee, was established by City and County governments to assist in the financing of new business and industry and to promote local expansion. The corporation was organized in accordance with the State of Tennessee Industrial Development Corporation Act. It is the intention of this Board to conduct its activities consistent with the provisions of the Act and the intent of the local legislative bodies in establishing the Corporation. To this end, the following guidelines will apply to the consideration of applications for industrial revenue bond financing:

1. In accordance with the requirements of state law the Board must find each project financed to be in the public interest. The basic guideline established by the legislature to determine whether the financing of a particular project is in the public interest is whether the project is likely to increase employment within the State of Tennessee. The Board interprets this to mean that the project results in a "net" increase in the number of jobs within the Memphis area (or a "net" savings of jobs which might otherwise be lost). Thus, projects which could be located elsewhere if Bond financing were not available will generally be approved subject to the financial and other requirements of the Board. Projects which could not reasonably be located elsewhere will not be approved. When the rules are applied to specific types of projects the Board has determined as follows:

   A. Industrial Projects for the manufacturing, assembling, processing or fabrication of agricultural, mining or manufactured products can generally be located in any number of communities without changing the basic economics of the enterprise. Thus, industrial revenue bonds provide a true inducement for the location of such facilities in the Memphis area and, barring unusual circumstances, the Board will approve any such facility which otherwise meets the Board's criteria.

B. Pollution Control projects have been found by the legislature to be in the public interest without regard to employment factors. Thus, any such facilities will be approved so long as the proposal otherwise meets the Board's criteria.

C. Distribution Facilities play a central role in Memphis' industrial growth and support a significant number of workers in the Memphis area. Due to the mobile nature of the modern distribution industry, such facilities could often be located outside of the Memphis area if more attractive financing were available. Thus, the Board concludes that distribution facilities, other than those which clearly serve only the immediate Memphis area, will qualify for Bond financing if such facilities otherwise meet the Board's criteria.

D. Office Building and Service Facilities would not normally fit within the Board's criteria for projects which produce a net increase of local jobs except where such facilities are incidental to projects which otherwise qualify for Bond financing hereunder. Exceptions may be made where it can be clearly demonstrated that the proposed facility will result in a net increase in the number of jobs in the Memphis area. This might result if the proposed facility is of a national or major regional character or where the availability of Bond financing will result in location of a facility in the Memphis area which would otherwise be located elsewhere.

E. General Commercial Projects, Retail Centers and Entertainment and Recreation Facilities will not be considered by the Board for financing.

F. Other Projects will be considered on a case-by-case basis.

2. Each applicant in its development, ownership and/or operation of a Board financed project will be required to comply with all laws, ordinances, orders, rules, regulations and requirements of duly constituted public authorities, which are or shall become applicable to the Project, the repair and alteration thereof and the use or manner of use of the Project.

3. Speculative development will not be considered as qualifying for bond financing.

4. A reasonable equity investment or other evidence of financial capability will be expected from all applicants. This may include investments in land, building, equipment or any tax producing improvements.

It may also include investments in furnishings necessary for the successful operation of the facility.

These guidelines are in addition to the normal rules and procedures of the Board and do not represent an exclusive list. From time to time and without notice, other important guidelines may be adopted and others deleted. These guidelines do, however, express the concern of the Board for the creation and preservation of permanent jobs, the preservation and expansion of the tax base, the improvement of the environment and the progress of the local economy. Exceptions may be made when a project, which would not otherwise qualify, provides significant contribution to the accomplishment of these goals.

APPLICATION PROCEDURES AND POLICIES OF THE MEMPHIS CENTER CITY REVENUE FINANCE CORPORATION

(Revised December, 1980)

The following constitute the basic procedures involved in application for the use of Industrial Revenue Bond financing through the Memphis Center City Revenue Finance Corporation ("Board"). The Board is not a financial institution and does not have any funds of its own available for loan. Any person wishing to utilize the Board's bond issuing authority should contact a bank, or an investment or mortgage banker or other financing source to determine the availability of funds prior to applying to the Board for financing. Financings will not normally be approved unless evidence of available financing has been submitted to the Board.

1. All applicants must complete and file with the Board an application in the form attached hereto. A Preliminary Board Application Fee computed according to the following schedule must accompany the application. This fee must be paid prior to the Board hearing the applicant's preliminary presentation. This fee will be non-refundable except in cases where the Board rejects the application for non-compliance with its application policies and will be credited against the Final Board Fee described below.

Estimated project cost at time of Application			Preliminary application fee
$ 0	-	$ 250,000	$ 100
$ 250,001	-	$ 500,000	$ 250
$ 500,000	-	$ 750,000	$ 500
$ 750,001	-	$1,000,000	$ 750
$1,000,001	-	$2,500,000	$1000
$2,500,001	-	$5,000,000	$1500
$5,000,001	-		$2000

2. A Final Board Fee computed as follows shall be paid to the Board on all financings.

1) 1/8% of 80% of the appraised value of the completed development seeking only a property tax freeze or only tax free financing.

2) 1/4% of 80% of the appraised value of the completed development seeking tax free financing and a property tax freeze.

Examples

Appraised Value	1/8% Fee Property Tax Freeze Only	1/4% Fee Tax Freeze and Tax Exempt Financing
$ 500,000. x 80% = $ 400,000.	$ 500.	$ 1,000.
$1,000,000. x 80% = $ 800,000.	$1,000.	$ 2,000.
$2,500,000. x 80% = $2,000,000.	$2,500.	$ 5,000.
$5,000,000. x 80% = $4,000,000.	$5,000.	$10,000.

This fee is a one-time charge to be paid at closing or in the alternative be divided and paid over a period of five years, with Board approval. In addition the Applicant shall be responsible to pay all Board and Bond Counsel fees and other expenses of the financing.

3. All applications will be reviewed by representatives of the Memphis Center City Commission and City and County governments and will be forwarded to the Board prior to formal consideration.

4. The Board will hold special meetings at the Petroleum Club, One Commerce Square called in the manner as provided in the By-Laws of the Board. At this time the Board does not hold regularly scheduled monthly meetings. All meetings of the Board will be public meetings as required by law.

5. Board consideration of any particular financing proposal will be conducted as follows:

a. Center City Commission staff will review the proposal, assist in preparation of the application, and in most cases make its definite recommendation to the Board.

b. At the next regular Board meeting following receipt of an application the Board will make a preliminary review as to the proposed financing. Preliminary approvals may be made at that time and may be subject to receipt of further information by the Board or to other conditions which the Board may require.

c. At a later meeting the Board will make a determination as to whether a particular Financing is to be approved.

Approvals will be subject to drafting of documentation in form satisfactry to the Board.

d. Final approval of an issue and documentation therefor will be given after receipt of a satisfactory legal opinion from the Board Counsel.

In specific cases the Board may choose to take more than one of the actions described above in a single meeting.

6. No financing will be approved unless the Board has first determined that such issue is in the public interest as required by law and that the proposed financing is economically sound. All applicants will be required to appear before the Board to respond to questions from the Board prior to approval of any financing. THE BOARD DOES NOT MAKE ANY RECOMMENDATIONS WITH REGARD TO THE PURCHASE OF ITS BONDS OR NOTES, NOR SHOULD ITS APPROVAL OF A FINANCING BE CONSTRUED AS A REPRESENTATION OF ANY SORT WITH REGARD TO THE FINANCIAL CONDITION OR SUITABILITY OF ANY FIRM BEING FINANCED THROUGH THE BOARD. ALL BOND OR NOTE PURCHASERS ARE EXPECTED TO MAKE AN INDEPENDENT INVESTIGATION OF THE BONDS OR NOTES OF THE BOARD AND THEIR SECURITY.

7. Adequate provision, in the form of an indemnity or otherwise, shall be made to assure the Board that full disclosure is made with regard to each financing and that all securities laws have been complied with. No financing requiring an underwriting will be approved unless an underwriter having a permanent office in Shelby County serves as one of the underwriters exercising due diligence with regard to the financing.

8. Prior to approval of any financing the applicant must make satisfactory arrangements with the Board with respect to payments of its fees and expenses in connection with the issue.

9. To avoid conflicts of interest no financing will be approved if Board Counsel or Bond Counsel has a professional legal relationship or direct or indirect ownership interest in the Applicant or any sponsor of the financing other than incidental representation or representations in connection with the proposed financing or similar issues. In the event of a conflict involving Board Counsel, special counsel shall be retained by the Board

to represent it in connection with the particular project being considered. In addition, no project shall be approved if any current Board member has a direct or indirect ownership interest in the Applicant or any sponsor of the Project.

10. The records of the Corporation shall be maintained in the offices of the Memphis Center City Commission.

11. The following criteria shall be considered in connection with each proposed project:

a. The project should comply with the Center City Action Program Concept Plan and other governmental plans and regulations.

b. The project being proposed must not have a substantial adverse impact on adjoining properties.

c. The property comprising the project must be substantially improved. In most cases this means that at least 50% of the total cost (including property acquisition cost and financing expenses) must consist of construction and renovation, but the Board may make exceptions to this guideline in specific cases.

d. Types of projects to be considered include commercial, apartments, hotels and office buildings. Industrial projects will be referred to The Industrial Development Board of the City of Memphis and County of Shelby, Tennessee.

12. With regard to projects owned by the Board, a payment in lieu of taxes shall be required by project lessees as follows:

a. For a period of fifteen (15) years commencing with the date of acquisition of the particular property by the Board, the amount of the payment in lieu of taxes shall be the amount of ad valorem taxes that were or would have been due and payable on the lease property for the period immediately preceeding the date of its acquisition by the Board.

b. For the period beginning with the end of the 15th year from the date of the acquisition of the property by the Board and running through the end of the 20th year of said date, the payment in lieu of taxes shall be in an amount equal to one-third (1/3) of the ad valorem taxes that would otherwise be due and payable with regard to the property were it owned by a tax paying entity and subject to property taxation, but in no event shall such taxes be less than the amount specified in a. above.

c. For the period beginning with the end of the 20th year from the date of the acquisition of the property by the Board and running through the end of the 25th year from that date, the amount of taxes shall be an amount equal to two-thirds (2/3) of the ad valorem taxes that would otherwise be due and payable with regard to the property were it owned by a tax paying entity and subject to property taxation, but in no event shall such taxes be less than the amount specified in a. above.

d. From and after the end of the 25th year from the acquisition of the property by the Board, the amount of the payment in lieu of taxes shall be that amount of taxes which would be due and payable on the property were it owned by a tax paying entity and subject to ad valorem taxation.

e. With regard to hotels, paragraph d. shall apply from and after the end of the 10th year after completion of the project.

13. Only projects which are located within the following geographical boundaries will be considered by the Board.

APARTMENTS:
North - North Parkway
South - Crump
East - Danny Thomas including properties with frontage on the east side of Danny Thomas
West - Mississippi River (including all of "Mud Island")

OFFICES:
North - North Parkway
South - Vance.Avenue
East - Danny Thomas
West - Mississippi River

COMMERCIAL:
North - North Parkway
South - Crump
East - Danny Thomas
West - Mississippi River (including all of "Mud Island")

HOTELS AND MOTELS:
North - North Parkway
South - Vance
East - Danny Thomas
West - Mississippi River (including all of "Mud Island")

Exception: Urban renewal land anywhere within the Center City area may be considered for commercial and office developments and any land within the area bounded by Danny Thomas on the West, I-40 on the North, Manassas on the East and Vance on the South will be considered for apartment development.

14. The procedures and rules set forth herein may be changed by majority vote of the Board at any regular or special meeting. At least seven (7) days public notice shall be given prior to any change in these rules and procedures.

(301) 659-4262

MARYLAND INDUSTRIAL DEVELOPMENT
FINANCING AUTHORITY
WORLD TRADE CENTER BALTIMORE
401 E. PRATT ST., SUITE 2244
BALTIMORE, MARYLAND 21202

JAMES C. JOHNSON
CHAIRMAN

OLIVER H. FULTON
EXECUTIVE DIRECTOR

October 5, 1981

Honorable Members
of the Committee:

We request the attached exhibits be introduced for the record. They are:

1) Copy of letter, dated September 18, 1981, from Governor Harry Hughes to Senators Mathias and Sarbanes, requesting their support in deferring implementation of IRS ruling 81-216.

2) Copy of letter, dated September 18, 1981, from James O. Roberson, Secretary of Maryland's Department of Economic and Community Development, to Treasury Secretary Regan, expressing concern over potential limitation on tax-exempt financing.

3) Copy of Secretary Roberson's statement before the Sub-Committee on Oversight, of the House Ways and Means Committee, on April 9, 1981.

4) Letter from John G. Fitzpatrick, Associate Director of the Maryland Industrial Development Financing Authority, dated October 5, 1981.

Very truly yours,

John G. Fitzpatrick,
Associate Director

JGF/ekf

Telephone Number for Hearing Impaired:
269-2609 Annapolis Area
565-0450 Toll-free Washington Area

AN AGENCY OF MARYLAND DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
AN EQUAL OPPORTUNITY EMPLOYER

STATE OF MARYLAND
EXECUTIVE DEPARTMENT
ANNAPOLIS, MARYLAND 21404

HARRY HUGHES
GOVERNOR

September 18, 1981

SAME LETTER SENT TO: THE HONORABLE PAUL S. SARBANES

The Honorable Charles McC. Mathias, Jr.
United States Senate
358 Russell Senate Office Building
Washington, D.C. 20510

Dear ~~Senator Mathias~~ Mac:

You have recently received a letter signed jointly by your colleagues, Senators Weicker, Durenberger, and Stevens notifying you that they would soon introduce legislation which would delay the implementation of a recent Internal Revenue Service (IRS) Ruling (IR-81-216 dated August 24, 1981). I strongly urge you to support this legislation.

The effect of the IRS ruling is to prevent states from bundling and simultaneously issuing "small-issue" development bonds (IDB) for small businesses and family farms. At this time, Maryland does not have a development bond program for farmers, but the 1981 Maryland General Assembly passed my administration's legislation which created an "umbrella bond" program in the State targeted to small businesses.

It is no secret that interest rates are at record high levels. Access to the tax-exempt bond market can reduce interest cost to borrowers. The "umbrella" bond concept reduces the cost of issuance for the borrowers by spreading those costs among those under the "umbrella."

I am concerned that the problems of capital availability for small businesses will only be exacerbated by this systematic attack on small business. As you know, the Small Business Administration, the Economic Development Administration, and the Farmers Home Administration now have reduced capabilities.

It should also be noted that the Oversight Subcommittee of the House Ways and Means Committee has been reviewing IDB financing and has introduced HR 4420 as a result of that review. I do not support that legislation. However, it seems that the Internal Revenue Service has preempted congressional review with regard to at least the "small-issue" IDBs.

I support congressional review of this matter, and I therefore support the Weicker, Durenberger, and Stevens legislation which would delay implementation of the IRS ruling to give the Congress adequate opportunity to decide the issue.

I would appreciate your assistance in this regard.

Sincerely,

Harry

Governor

Maryland Department of Economic & Community Development

Harry Hughes
Governor
James O. Roberson
Secretary

Office of the Secretary 2525 Riva Road Annapolis, Maryland 21401 301/269-3174

September 18, 1981

The Honorable Donald T. Regan
Secretary of the Treasury
15th and Pennsylvania Avenue, N. W.
Washington, D. C. 20220

Dear Secretary Regan:

I am writing to urge that the Treasury Department oppose HR 4420, sponsored by Congressman Charles B. Rangel, and any other Congressional efforts to limit the ability of state and local governments to issue industrial development bonds (IDBs).

Considering the nation's present uncertain economic condition, it seems incongruous that the federal government would limit or abolish a program so critical to encouraging capital investment and job creation. Rather, the federal government should be supporting programs to revitalize America's economy. The importance of IDBs is presently underlined by the ability of IDBs to provide below market interest rates to small and medium sized firms, at a time when these firms are being strangled by record high interest rates.

It is my concern that the long-term and overall economic benefits of IDBs are being overshadowed by a narrow examination focusing solely on tax policy and immediate revenue loss to the federal treasury. Recent history demonstrates the folly of this approach. As a prime example, the Mortgage Subsidy Bond Tax Act of 1980, incorporated into the fiscal year 1981 Budget Reconciliation Resolution, was enacted without due consideration of its impact on the housing industry and the provision of homeownership opportunities for low and moderate income families. As a result, state and local efforts to provide homeownership have virtually come to a halt, with a resulting severe impact on the housing and real estate industry. While the limited abuses were terminated, it was achieved at a significant and uncontemplated social and economic cost to the nation.

I am enclosing a copy of my testimony on IDBs before the Oversight Subcommittee of the House Ways and Means Committee. The testimony deals with a number of issues raised by the Congressional Budget Office's study of IDBs. I would like to mention two of the points in the testimony. First, it is important to remember that state and local governments, as well as the federal government, incur a revenue loss with the issuance of IDBs. I know of no state program authorizing IDBs which does not also

TTY for the Deaf 301-269-2608

exempt the interest payable on such bonds from state and local income taxes. State and local governments recognize that the net benefits are worth the cost. The second concern is about the use of IDBs for commercial projects. While commercial projects are ineligible under the state tax-exempt financing program in Maryland, unless more than 50% of the commercial firms' market is out of state, I sincerely believe that the decision to eliminate IDBs for commercial projects is a matter to be determined by state and local governments in accordance with their economic development goals. State and local governments can act responsibly in this matter, and what is economically appropriate for Harlem may not be appropriate in Houston. It is ironic that the federal government would want to limit state and local government discretion, at a time when it is busily turning over to state and local governments more authority in the spending of federal revenues through the various block grants. Again, as an example, the federal government says Maryland is capable to assume control over the expenditures of $10 million in federal small cities community development block grant funds, and additional millions in education and human service funds, but is not capable to issue IDBs - something it has done for almost twenty years. This position simply defies logic. Programmatic limitations on IDBs would appear to be a complete reversal of the Reagan Administration's "New Federalism".

I would be happy to supply you with a list of IDB financed projects throughout Maryland to demonstrate the net benefit of IDB financing through increased economic activity. IDBs have proven to be an especially critical tool in furthering economic growth in economically depressed areas of high unemployment, and the state tax-exempt financing program makes special allowances for these areas. It is important to understand, however, that IDBs are an important tool in promoting the economic development of the entire state.

I sincerely hope that the Treasury Department will not support Congressional efforts to limit IDBs, and thus retreat from the Reagan Administration's policies to revitalize the nation's economy and return more responsibility to state and local governments.

Sincerely,

James O. Roberson

JOR/jc
Enclosure

Statement Of

JAMES O. ROBERSON
SECRETARY
Maryland Department of Economic and Community Development

before the

Subcommittee on Oversight
House Ways and Means Committee

April 9, 1981

Thank you Mr. Chairman.

My name is James O. Roberson. I am Secretary of the Maryland Department of Economic and Community Development, a principal agency of the government of the State of Maryland.

Our Department is charged with the responsibility of promoting industrial location and expansion within the State.

Tax-exempt financing has been used extensively, effectively and responsibly to help us meet our objectives.

In Maryland, tax-exempt financing is available in two different forms.

Under the first method, each county and municipal corporation in Maryland (including the City of Baltimore) have been empowered by the Maryland General Assembly to issue tax exempt industrial development revenue bonds to finance industrial buildings. Such authority has existed since 1963.

Eligible projects include buildings for use as a factory, mill, shop, processing plant, research and/or development laboratory, warehouse, assembly plant, fabricating plant, port facilities, pollution control facilities, offices and machinery and equipment related to any of the foregoing. Commercial facilities are included.

In Maryland, the participating local government issues and sells revenue bonds to finance a specific project for a specific company. In most cases, the local government lends the proceeds of the sale of the bonds to the participating company, so that the company can acquire the proposed project. In the alternative, the local government can acquire the proposed project and lease or sell the facility to the company. The company agrees to make loan payments, rental payments or purchase payments, as applicable, to pay the principal and interest on the bonds.

If the participating company defaults, the local government is not obligated to and is prohibited under Maryland law from paying the principal and interest on the bonds. The holder of revenue bonds must look only to the collateral pledged by the participating company as security for the bonds.

The procedure used by each local government in Maryland to issue industrial revenue bonds is similar to that of local governments in all other states that issue such bonds. Although there is no state requirement to do so, almost without exception such bonds are issued only after a public hearing on the proposed project is held by the local government, thus ensuring citizen participation and input. Each local government must determine that a legitimate public purpose such as the relief of conditions of unemployment, the encouragement of industrial expansion, the reduction of pollution of the environment, and the protection of the health, welfare and safety of the citizens of Maryland will be served by the issuance and sale of the revenue bonds.

There is no requirement that local governments register the sale of industrial revenue bonds with the state; thus, there is no clearinghouse which can provide precise figures with respect to the total amount of industrial revenue bonds that have been issued since 1963 under this first method of tax-exempt financing in Maryland.

However, my Department does closely monitor such issues and has estimated the total amount of IRBs issued by local governments from 1963 through 1979 at $630,000,000.

The second method of providing tax-exempt financing in our state is through the Maryland Industrial Development Financing Authority, an agency of the Maryland Department of Economic and Community Development, referred to as "MIDFA."

MIDFA was established by the Maryland General Assembly in 1965 for the purpose of aiding the financing of business enterprises seeking to locate or expand their operation in Maryland.

MIDFA consists of a nine-member board, seven of whom are leaders in the private business community who serve in a pro bono capacity, and are appointed by me with the approval of the Governor. My designee, and the State Treasurer currently serve as ex-officio members.

By approving loans made by private lenders, MIDFA enables certain eligible companies (defined below) to obtain loans at a higher percentage of project cost, at a lower interest rate and for a longer term than is normally available from conventional sources. Land, buildings, and equipment can be financed through this program.

A MIDFA approved loan is an industrial development revenue bond within the meaning of Section 103(b) of the Internal Revenue Code. Generally, a Maryland county, municipality, or agency issues and sells the revenue bonds to a lender (usually a commercial bank) and then relends the proceeds of the sale of the revenue bonds to the eligible company to acquire the proposed industrial project. Loan payments are made by the company to the issuer of the bonds to coincide in amount and term to the loan payments required by the lender. The faith and credit of the issuer of the bonds are not pledged for the repayment of the loans.

MIDFA has a dual function. First, it approves loans for the tax-exempt financing and second, it insures through its insurance fund the repayment of all or any portion of the loan. Usually, the two functions are combined. However, in many instances a company may request approval for tax-exempt status but the lender will not require insurance. Approximately 75% of MIDFA loans require some insurance.

MIDFA is permitted to insure any portion of the loan up to 90 percent of the cost of land and buildings and up to 70 percent of the cost of equipment. The loan, however, may be made up to 100% of eligible costs. MIDFA's insurance is limited to $5 million per project. The faith and credit of the State of Maryland are not pledged for the repayment of the loans.

To be eligible for participation under the MIDFA program, a company must qualify in each of the following three categories:

1. Legal eligibility determined by the nature of the business activity;
2. Demonstration of substantial economic impact on the State of Maryland and the local community where the proposed project will be located; and
3. Creditworthiness of the company and the value of the collateral securing the loan.

The categories of legally eligible business activities are tightly controlled and limited to the following:

a. industrial and manufacturing

b. warehousing of manufactured, agricultural or seafood products

c. research and development

d. certain tourist and convention facilities

e. mercantile, retail or service facilities if they primarily serve out-of-state markets

f. office buildings for corporate headquarters or regional offices

g. certain port improvements and public use airport facilities

h. production of gasohol

i. racetracks or sports arenas

j. dredging and disposal of spoils

Commercial activities are not permitted unless more than 50% of the business activity will serve a market outside of the State of Maryland.

I have attached to this statement for consideration by the Subcommittee, summaries of the two methods of tax-exempt financing in Maryland.

We have read with a great deal of interest the study on Small Issue Industrial Revenue Bonds and would like to comment on some of the observations made in the study and the policy alternatives which are provided.

The April 1, 1981 report of the Congressional Budget Office - which I commend for its non-partisan thoroughness - points out that states and local governments have historically determined the uses for which proceeds from small issue IRBs can be used.

I would recommend that, given the direction we perceive being taken by the new administration, state and local governments continue to make those determinations. As the report suggests, these governments are in the best position to judge the merits of different projects on their economies.

I think it is important to point out to the subcommittee that the revenue loss to the Federal government from small issue IRBs is shared by state and local governments — a fact that is ignored by the CBO report.

Indeed, I know of no state programs authorizing IRBs which do not also exempt the interest payable on such bonds from state and local income taxes.

Such action suggests that tax exempt financings are, in fact, a "partnership" arrangement between the federal, state and local governments to induce desirable capital expenditures by the private sector.

The CBO report repeatedly points out that the small issue IRBs have grown dramatically in the past few years. The reason for this unparalleled growth is obvious; i.e., the equally unparalleled growth in interest rates over the same period of time.

Not examined in any depth, however, is the question of whether the capital investment that occurred during this period would have occurred irrespective of the availability of tax exempt interest rates.

While I can offer no hard data, I have been told repeatedly by officials of smaller companies that they would not have gone forward with capital expenditures had they been required to pay conventional interest rates. Such officers say they would have indefinitely delayed or abandoned planned expansion without access to the lower interest rates IRBs provide.

Their statements suggest that before Congress takes any steps towards eliminating tax-exempt financing, a careful analysis should be made of the potential loss of other revenues resulting from decreased capital expenditures - personal income tax paid by employers and the whole range of other taxes and duties imposed by the federal government.

The CBO report suggests a number of policy options for your investigation.

Of the recommendations that CBO outlines, the one that would have the most positive effect on re-industrializing America would obviously be to remove all limits on IRBs.

It is my view, however, that the removal of such limits would greatly impair the ability of state and local governments to market general obligation bonds.

The recommendation to raise the so-called "clear" $1 million limit to $3 million and to raise the capital expenditure limit from $10 to $15 million deserves this Subcommittee's consideration. The effect inflation has had since the existing limits were imposed is well known to this Subcommittee; the CBO report indicates the current equivalents would be $2.8 million and $14 million respectively if the existing limits were adjusted for inflation.

While we do not recommend maintaining the current law "as is," we agree with the need to report IRB sales to each of the states and the Congress.

Targeting IRBs to smaller companies or to economically distressed areas may be socially desirable but very difficult, as the report states, to accomplish with equity. (The Subcommittee will no doubt recall that the Economic Development Administration began its programs to "target" aid to distressed areas and currently has approximately 90 percent of the nation determined to be eligible for EDA assistance.)

Eliminating IRBs for commercial projects is a matter to be determined by state and local governments in accordance with economic development goals they have identified and adopted.

Limiting state IRB sales on a per capita basis would provide for a wide disparity of incentives to be available to those states that are seeking to re-industrialize (such as those in the northeast) and those states that are just now developing an industrial economy.

We would not recommend that only revenue bonds backed by the full faith and credit of the state be tax exempt since in many states, including Maryland, such bonds are unconstitutional.

Requiring matching funds or commitments from federal, state or local resources so that project eligibility criteria will be more stringently controlled, has merit. As I mentioned earlier, in Maryland, when Maryland Industrial Development Financing Authority insurance is involved, the criteria for approval of an IRB is more restrictive than the requirements of Section 103(b) of the Internal Revenue Code.

We would strongly urge that the pledge of insurance or other state funds be considered an adequate commitment of "resources."

Finally, to totally eliminate exempt small issues would, based on our state's experience, reduce the amount of total capital investment that would be made particularly by smaller and minority-owned companies.

In summary, we would recommend that Congress take those steps necessary to enhance the economy recovery of our country by:

a. recognizing the partnership relationship of IRB to the revenues of the federal, state and local governments;

b. increase the limits presently imposed on the size of IRB issues to at least reflect the realities inflation has caused since the limits were last adjusted; and

c. examine the desirability of requiring commitments from one or more levels of government to achieve tax exempt status for small issue industrial revenue bonds.

Thank you, Mr. Chairman, for your attention and for the opportunity to testify before you today.

I will be pleased to answer any questions the committee may have.

Attachment, Page 1

As of December 31, 1980

MIDFA CLOSED LOANS UNDER ONE MILLION DOLLARS

FISCAL YEAR (ending 6/30)	NO. OF LOANS		PROJECTED NEW JOBS		ORIGINAL COMMITMENT	
	TOTAL	DEP. AREA*	TOTAL	DEP. AREA*	TOTAL	DEP. AREA*
1976	5	3	149	87	$ 2,495,000	$ 1,425,000
1977	7	1	663	59	3,459,500	490,000
1978	9	5	376	265	3,011,500	1,707,500
1979	11	5	304	138	4,699,900	1,963,000
1980	29	11	943	480	13,541,129	6,364,129
1981 (6 mos.)	12	5	434	183	6,947,650	2,690,000
Total	73	30	2,869	1,212	$34,154,679	$14,639,629

TOTAL MIDFA CLOSED LOANS (ALL UNDER TEN MILLION DOLLARS)

FISCAL YEAR (ending 6/30)	NO. OF LOANS		PROJECTED NEW JOBS		ORIGINAL COMMITMENT	
	TOTAL	DEP. AREA*	TOTAL	DEP. AREA*	TOTAL	DEP. AREA*
1976	7	4	206	144	$ 4,685,000	$ 2,605,000
1977	9	3	703	99	5,789,500	2,820,000
1978	9	5	376	265	3,011,500	1,707,500
1979	22	6	1,755	457	29,806,900	6,532,000
1980	52	17	2,835	856	56,168,591	15,658,129
1981 (6 mos.)	15	5	574	183	11,823,650	2,690,000
Total	114	40	6,449	2,004	$111,285,141	$32,012,629

*Depressed Area - denotes high unemployment.

4/81

Attachment, Page 2

As of December 31, 1980

MIDFA CLOSED LOANS UNDER ONE MILLION DOLLARS

Fiscal Year ending 6/30	Total No. of Loans	Number of Insured Loans	Total Loans Original Commitment	Insured Loans Original Commitment	Total Insurance Original Commitment
1976	5	5	$ 2,495,000	$ 2,495,000	$1,911,000
1977	7	7	3,459,500	3,459,500	1,760,375
1978	9	9	3,011,500	3,011,500	1,236,805
1979	11	9	4,699,900	4,454,900	1,707,725
1980	29	17	13,541,129	6,756,690	2,513,457
1981 6 mos.	12	9	6,947,650	5,097,650	1,972,630
	73	56	$34,154,679	$25,275,240	$11,101,992

IRB LOANS UNDER ONE MILLION DOLLARS

Fiscal Year	No. of Loans	Total Loans Original Commitment
1976	5	$ 3,100,000
1977	3	1,800,000
1978	7	5,100,000
1979	24	15,400,000
1980	26	16,700,000
1981 6 mos.	27	13,100,000
	92	$35,200,000

TOTAL IRB AND MIDFA LOANS UNDER ONE MILLION DOLLARS

No. of Loans	Total Original Commitment
10	$ 5,595,000
10	5,259,500
16	8,111,500
35	20,099,900
55	30,241,129
39	20,047,650
165	$89,354,679

4/81

(301) 659-4262

MARYLAND INDUSTRIAL DEVELOPMENT
FINANCING AUTHORITY
WORLD TRADE CENTER BALTIMORE
401 E. PRATT ST., SUITE 2244
BALTIMORE, MARYLAND 21202

JAMES C. JOHNSON
CHAIRMAN

OLIVER H. FULTON
EXECUTIVE DIRECTOR

October 5, 1981

Honorable Members
of the Committee:

The State of Maryland, through action of its legislature in 1981 session, authorized the implementation of an "umbrella" bond program for the pooling of small-issue IDBs. The primary purpose of the program is to broaden the availability of tax exempt financing to more small businesses through the reduction of issuance costs and by providing broader access to national institutional and "retail" buyer markets. Considerable time and money has been spent thus far in developing our program.

The statewide program of tax-exempt financing, administered by the Maryland Industrial Development Financing Authority (MIDFA) has been quite successful in assisting small businesses. Eighty-six (86%) of the loans approved by our agency in fiscal year 1981 were made to businesses with less than 250 employees, and 39% financed projects in economically depressed areas.

The MIDFA Authority, comprised of seven public members serving in a pro bono capacity and two ex-officio members, review all proposals seeking State assistance and determine that the proposed projects are legally eligible, credit worthy, and demonstrate substantial economic impact. The Authority performs a dual function: 1, the approval of tax exempt status and 2, the insuring or guaranteeing of all or a portion of the loan.

We have attached an economic cost/benefits analysis of a proposal presented to us for consideration last year. It is interesting to note the net effect of this proposed tax exempt financing. Much attention has been given to the estimated revenue loss incurred by the federal government through the broad use of IDBs, but little is heard of the other benefits accruing from such financing.

We feel that the implementation of IRS ruling 81-216, and other efforts to severely restrict the use of industrial development bonds, will adversely impact the nation's economy and will have a particularly damaging effect on small business.

Very truly yours,

John G. Fitzpatrick,
Associate Director

JGF/ekf

Telephone Number for Hearing Impaired:
269 2609 Annapolis Area
565-0450 Toll-free Washington Area

AN AGENCY OF MARYLAND DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
AN EQUAL OPPORTUNITY EMPLOYER

Maryland Industrial Development
Financing Authority

Cost/Benefits Analysis of Tax Exempt Financed Project

This analysis was performed in 1980 for a proposed motel financing which would utilize tax exempt financing in the amount of $6 Million for a 20 year term at a proposed tax exempt rate of 11%. Prior to the formal submission of application, the developer was successful in obtaining conventional financing at acceptable rates, and the request for an IDB was withdrawn. However, the cost to the state and federal governments from revenues lost because of the tax exempt rate vs. the income benefits to be derived from the motel's operations provide an interesting comparison.

The revenue and income projections were prepared by a national consulting firm. For the sake of conservatism, these were scaled back slightly for the purposes of this analysis, as were the revenue projections to be derived from various taxes. The analysis was performed by the staff of the Maryland Industrial Development Financing Authority.

Projected Revenues (by 2nd year of operation)		$3,610,000
Income before fixed charges	$1,209,000	
Less interest expense on $6 Million at 11%	660,000	
Less depreciation on $6 Million (straight-line for 20 years)	300,000	
Pre-Tax Income		$249,000
Federal Income Tax (presumed 40% rate)	99,600	
State Income Tax (presumed 7% rate)	17,430	
County "Piggyback" Tax (at 50% of state tax)	8,715	

* * * * *

Real Estate Taxes:

Based on a $3,000,000 assessment (50% of market value)

State Real Estate Tax (21¢ per $100 valuation)	6,300
County Real Estate Tax ($2.25 per $100 valuation)	67,500
Total Real Estate Taxes	$70,800

* * * * *

State Sales Tax (5% of total sales)	$180,500

* * * * *

85 Employees

Average Wage of $7,500 per year x 85 =	$637,500
State Income Tax (Average 4.5%) =	28,688
County "Piggyback" Tax (50% of state tax)	14,344
Federal Income Tax (presuming 10% standard deduction and tax rate of 20%)	$114,750

* * * * *

Revenues lost by U. S. Government by not receiving income tax from lender on interest income:

$6 Million loan; 20 year term; 11% rate

Average outstanding balance over loan term	$3,000,000
Annual interest income @ 11%	$330,000
Federal Income Tax at 27% (average rate of selected regional banks)	$89,100

* * * * *

Tax Revenues to be Derived from project:

	Federal	State	County	Total
Corporate Income	$ 99,600	$ 17,430	$ 8,715	
Personal Income	114,750	28,688	14,344	
Sales Tax		180,500		
Real Estate		6,300	67,500	
Total	$214,350	$232,918	$90,559	$537,827

Annual Total Tax Revenues	$537,827
Annual Federal Tax Revenues	$214,350
Annual Federal Tax sacrificed by Tax exempt status	$ 89,100

NJEDA

New Jersey Economic
Development Authority

John J. Horn
Chairman

James J. Hughes, Jr.
Executive Director

October 9, 1981

James O'Connell, Economist
U.S. Senate Select Small Business Committee
424 Russell Senate Office Building
Washington, D.C. 20515

Dear Mr. O'Connell:

Enclosed is our written testimony to the Subcommittee on Rural and Economic Development, U.S. Senate Select Committee on Small Business, regarding tax exempt small issue industrial development bonds. Please include this testimony in the record of your oral hearings of October 5, 1981.

The New Jersey Economic Development Authority favors legislation to withdraw or postpone IRS Ruling 81-216. The economy of New Jersey is adversely affected by this ruling in three major ways:

1 - It terminates efforts to develop an umbrella IDB program for small businesses generally precluded from using IDBs.

2 - It causes awkward structuring of (a) projects at multiple locations and (b) multiple projects at a single site, thus creating additional bond marketing costs.

3 - It hinders IDB access to the public financial markets.

Sincerely,

James J. Hughes, Jr.
Executive Director

Capital Place One - CN 990, 200 South Warren Street, Trenton, New Jersey 08625 • Telephone (609) 292-1800

NJEDA
New Jersey Economic Development Authority

John J. Horn
Chairman

Anthony M. Cuccia
Acting Executive Director

Written Testimony By

James J. Hughes, Jr.
Executive Director

New Jersey Economic Development Authority
Trenton, New Jersey

To the

U.S. Senate
Select Committee on Small Business
Subcommittee on Rural and Economic Development

Concerning

Tax Exempt Small Issue Industrial Development Bonds
and specifically
IRS Revenue Ruling 81-216

October 9, 1981

Capital Place One - CN 990, 200 South Warren Street, Trenton, New Jersey 08625 • Telephone (609) 292-1800

Testimony Concerning IRS Revenue Ruling 81-216

New Jersey Economic Development Authority

To the

U.S. Senate Select Committee on Small Business

October 9, 1981

The New Jersey Economic Development Authority is the sole issuer of tax exempt small issue industrial development bonds in New Jersey. IRS Revenue Ruling 81-216 affects the Authority's activities in three ways:

1. It terminates efforts to develop an umbrella IDB program for small businesses generally precluded from using IDB's.
2. It causes awkward structuring of (a) projects at multiple locations and (b) multiple projects at a single site, thus creating additional bond marketing costs.
3. It hinders IDB access to the public financial markets.

New Jersey's efforts to establish an umbrella IDB program has been in direct response to inquiries both by applicants and municipalities. The purpose of the new program was to improve the access of small business to tax exempt industrial development bonds.

In 1980, 86% of all IDB users in New Jersey had sales of less than $20 million, and 11% had sales of $500,000 or less. Such businesses are limited in their access to IDBs because of the cost of formulating and marketing the bond. Their access to credit often involves interest rates substantially above the prime rate. Further, such businesses seldom obtain capital through the issuance of stock or corporate bonds. In addition, such businesses may be restricted in the utilization of retained earnings due to low profitability connected with start-up costs. Small and many medium sized businesses therefore, can obtain capital only from commercial lending institutions. Even then, they must compete with larger or older corporations considered to be good customers of the institution. Often small companies are able to obtain commercial credit only at rates up to four percentage points above prime.

The umbrella IDB helps to relieve these financial resource problems. The tax exemption cannot be considered either an obsolete tax incentive or a tax abuse. Small businesses create the largest employment growth sector and are significant in the development of new products and improved productivity. The concept of the umbrella IDB is to improve the use of credit by small businesses as well as allow them to seek loans too small to be financed individually by an IDB. IRS Revenue Ruling 81-216 precludes this program.

The NJEDA emerging umbrella IDB was developing along these lines: A pool of separate series of IDB projects would be packaged and sold to the public under a single offering supported by an underwriter. Each IDB series would be supported by the letter of credit of a local initiating bank in the amount of principal and a specified amount of interest of the series. The entire issue would be supported by "master" letters of credit issued by a large money center bank in the amount of the outstanding principal of the entire bond issue and at a specified amount of interest.

The NJEDA umbrella issue was to be comprised of 25 $1 million issues to 25 different firms. No single issue would have exceeded the $1 million limit. The pool arrangement was simply to improve the marketability of this issue for companies which otherwise would not have been able to obtain IDB financing. With a successful closing of this IDB series, NJEDA was planning to develop a series containing much smaller individual bonds in the order of $200,000 each. Individually, these types of smaller projects are difficult to finance or market at present.

The new IDB series program would improve the availability of capital to small businesses while eliminating the administrative costs of a loan guarantee and direct loan program. Previous to IRS Revenue Ruling 81-216, NJEDA had been discussing this first small business umbrella in New Jersey with an underwriter and a large money center bank.

Another area of NJEDA activity affected by IRS Revenue Ruling 81-216, involves aggregate issues for financing a duplicate facility at more than one location, or separate portions of a single facility. NJEDA is now exploring methods to separate the security for each of these issues and stagger the date of each issuance to avoid classification of the issuer under IRS Revenue Ruling 81-216. The period of time necessary for such staggering is unknown since it was not specified in the IRS Revenue Ruling. Some of NJEDA's aggregate bond issues have been separately secured in the past, however, it has been the banks that have preferred pooled security as an added insurance against the default of any part of the series issue. However, even with separate security, where one issue is secured by machinery and equipment, for instance, another by land and another by the building, the issuance of the aggregate bonds on the same day, puts them within the criteria for an umbrella ruling as defined by IRS Revenue Ruling 81-216.

The ruling, therefore, has made the issue of aggregate bonds more difficult to structure and market and adds to cost.

NJEDA is now in the process of appealing to the IRS for approval of an aggregate bond issue which had received significant commitment prior to August 24, 1981. This bond issue appears to fall under IRS Revenue Ruling 81-216. Under the IRS transition phase, we are seeking permission to issue the bonds for this particular applicant. This particular application has been in process for a number of months prior to issuance of the ruling.

A major aspect of the umbrella bond program would be its public market access. This is expected to improve interest on the part of lending institutions in participating in this program. This program permits the local bank to concern itself only with the credit issue in determining its participation in the program. While the institution would have the option of purchasing the bonds for its own portfolio, the risk of interest rate fluctuation normally would be born by a bondholder rather than the lending institution.

Each IDB series would be supported by a letter of credit by a local initiating bank and the entire issue would be supported by "master" letters of credit issued by a large money center bank. It is expected that a pooled bond issue secured in this manner would receive an investment grade rating from Moody's or Standard and Poor's reflecting the strength of the "master" bank, rather that of the underlying borrower.

In addition, the initial bond purchaser, the managing underwriter, would be expected to form a consortium of securities firms each of which would accept responsibility for a fixed par amount of the bonds. The consortium would be responsible to market the IDB series.

STATEMENT
TO THE
SMALL BUSINESS COMMITTEE
U.S. SENATE

on

Industrial Development Bonds

and

Pollution Control

2

Prepared By

Richard L. Hanneman
Director
Government and Public Affairs

National Solid Wastes Management Association

For the Record of

October 5, 1981 Hearings

The National Solid Wastes Management Association is the national organization representing private firms comprising the waste service industry. A great majority of our members are the many small businesses involved in collection of residential, commercial and nonhazardous industrial refuse, as well as its disposal. Because industrial development bonds and the ability to pool small issues has been a valuable financial tool for small private waste service firms to undertake new capital investment, NSWMA joins the distinquished coalition of Senators in opposing the recent IRS ruling prohibiting bond pooling. NSWMA also reaffirms its continuing support for the use of industrial development bonds in financing pollution control facilities.

The solid waste management industry is very competitive. There are only four large national corporations in the industry; it is the intent of the Small Business Administration under its size standard regulation to be proposed shortly to exclude only those few large firms from its definition of small business. By our estimates, the approximately 10,000 small waste service businesses earn about 80% of the total waste service revenues in this country.

The ability to pool small bond issues into offerings of attractive size to investors, along with the SBA pollution control bond guarantee program, has been vigorously promoted by SBA, and by the U.S. Environmental Protection Agency. According to EPA's recent publication, Federal Financial Assistance for Pollution Prevention and Control, only two states lack state revenue bond financing programs for pollution control, and in only five states, cities and/or counties do not have similar programs.

It is certainly a truism that small firms have more limited access to capital than large firms, and this is as true in the solid waste industry as in any other. The access of our small businesses to IDBs and the bond pooling program has enabled them to continue to compete more effectively and to provide more economical services to their customers, many of whom are themselves small businesses. Studies by Columbia University under a grant from the National Science Foundation have shown that the cost of contract refuse service provided by private firms averages 29% less than the same service provided by a public agency. The continued competitiveness of small private waste firms is good public policy.

One example of the use made of small industrial bond issues by our members is to finance transfer stations. Transfer stations are processing areas to amalgamate garbage truck loads into an economic size and form to be further transported to a distant sanitary landfill. Transfer stations have become an important option as landfill sites begin to move farther away from where the waste is generated.

NSWMA is concerned about the attack by the IRS on the industrial bond concept. Many of our members, such as those firms building resource recovery plants and those who own and operate larger sanitary landfills, have been able to use these bonds to help in financing sorely needed facilities for waste management. In addition, we strongly support the eligibility of hazardous waste facilities for industrial development bonds. Currently, IRS has ruled these facilities are ineligible because the IRS Code uses an outmoded definition of solid waste, which does not include hazardous waste. (Congress changed the definition of solid waste to include hazardous waste way back in 1976; the IRS refuses to accept the new definition.)

This would help our industry provide small manufacturing firms which generate hazardous waste but do not have the capacity to dispose of their own waste with much needed expansion in off-site treatment and disposal capacity.

NSWMA appreciates the opportunity to share our concerns with the subcommittee.

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